Prince Edward Island
Budget Highlights 2002-2003

A Balanced Response to Difficult Times

Presented by
The Honourable Patricia J. Mella
Provincial Treasurer
March 26, 2002

Prince Edward Island

Budget Highlights 2002-2003

A Balanced Response to Difficult Times

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Prince Edward Island

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A Balanced Response to Difficult Times

Overview

Building Blocks

- Health Care
- Education
- Job Creation
- Community Development

We will continue to take a balanced approach and focus on clear public priorities which will lead to balanced results. We know we must invest in the future and not allow short term challenges to take away from our long term goals.

Patricia J. Mella
Provincial Treasurer

Budget Summary:

	2002-2003 Estimate ($ millions)	2001-2002 Forecast ($ millions)	2001-2002 Estimate ($ millions)
Revenues:			
Provincial Source	585.4	550.0	545.8
Federal Source	366.1	399.9	389.9
Capital	.7	.7	.4
Sinking Fund Earnings	16.2	21.6	21.6
Total Revenues	**968.4**	**972.2**	**957.7**
Expenditures:			
Program Expenditures	857.1	830.3	808.2
Interest Charges on Debt	106.5	106.1	109.0
Capital	16.4	30.9	28.9
Total Expenditures	**980.0**	**967.3**	**946.1**
Surplus (Deficit) Before Investment in Extraordinary Capital Project and Special Adjustments	(11.6)	4.9	11.6
Extraordinary Capital Project and Special Adjustments			
East Prince Health Facility	21.0	19.4	13.0
Pension Adjustment	-	-	(3.0)
Workforce Renewal Program	(3.8)	-	-
Total Adjustments	17.2	19.4	10.0
(Increase)/Decrease in Net Debt	(28.8)	(14.5)	1.6

Forecast 2001-2002:

Revenues:
Forecast revenues are up $14.5 million from Budget Estimate 2001-2002. The following are the major changes:

Equalization	$ 7.3 million
Personal Income Tax	$ 2.8 million
Municipal Infrastructure	$ 2.4 million
Health Tax on Tobacco	$ 2.1 million
Property Tax	$ 2.0 million
Licenses and Permits	$ 1.8 million
Health Information System (CHIP)	$ 1.6 million
Fees and Services	$ 1.3 million
Corporate Taxes	($6.0 million)
Gasoline Tax	($1.3 million)
Various	$ 0.5 million

Expenditures:
Forecast expenditures are up $21.2 million from Budget Estimate 2001-2002 in the following areas:

Negotiated Salary Settlements	$ 4.6 million
Municipal Infrastructure Program	$ 3.2 million
Workforce Renewal	$ 2.7 million
Health Information System (CHIP)	$ 2.6 million
Additional Highway Maintenance	$ 2.0 million
Funding to Higher Education	$ 1.4 million
Employment Development	$ 1.2 million
School Board Deficits	$ 1.1 million
Tourism/Marketing	$ 0.9 million
Community Development	$ 0.7 million
Various	$ 0.8 million

East Prince Health Facility is ahead of schedule by $6.4 million.

Fiscal Responsibility

Budget Estimate 2002-2003:

Tax Measures:

(1) Health Tax on Tobacco will be raised by $5 per carton of 200 cigarettes and proportionate increases raised on related tobacco products. This measure follows similar steps in other provinces.
(2) Gasoline Tax will be increased by 1 cent per litre as of midnight tonight.

Revenues:

Provincial source revenues will increase $39.6 million or 7% from budget 2001-2002. This is due to increases in health tax on tobacco products and increases in gasoline taxes along with growth in personal income, sales and property taxes.

Federal source revenues are expected to decrease $23.8 million made up of an equalization decrease of $20 million, decreased funding for Minority and Second Language of $2.9 million and various items amounting to $0.9 million.

Expenditures:

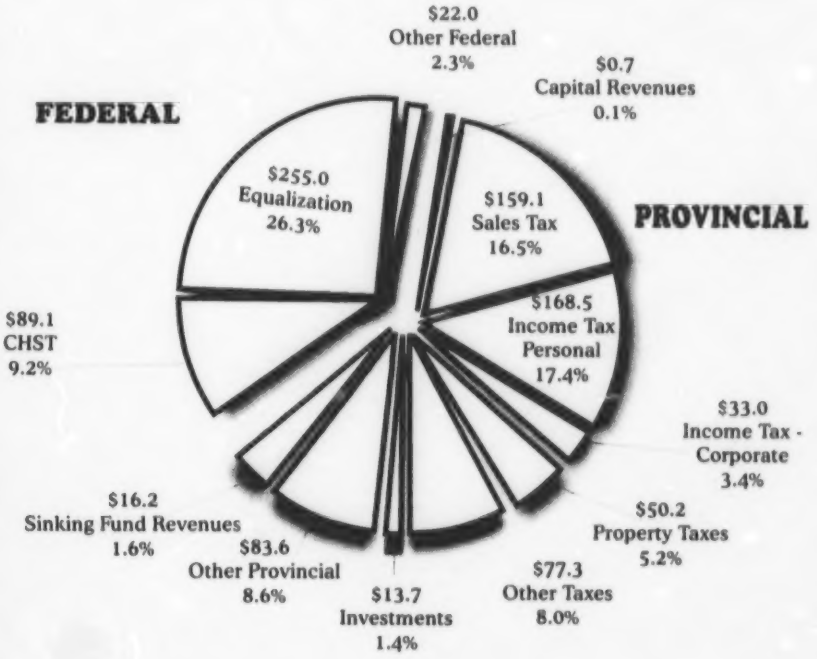
Total expenditures are up $41.8 million or 4.3% from Budget 2001-2002. Salary increases government wide represents $28 million of this increase. East Prince Health Facility expenditures will be $21 million, up $8 million. The remaining expenditure increase of $5.8 million or approximately one-half of 1% is spread throughout Government.

Where the Money Comes From

Revenues:

Total revenues are up $10.7 million from the 2001-2002 Budget Estimate.

2002-2003 Revenues
Where the Money Comes From
($ millions)



Expenditures:

Total expenditures are up by $41.8 million over 2001-2002 Budget Estimate.

2002-2003 Expenditures
Where the Money Goes
($ millions)

Health and Social Services

Achievements

- Last fiscal year, more than 45 registered nurses began working in our government health facilities.
- Eight family physicians and 12 specialists were recruited.
- Additional funding of $2.6 million was provided to the Health Information System (CHIP).
- Health Regions received maximum accreditation status.

New Initiatives

- Funding of $11.2 million for construction and operating cost of a new MRI service and continued expansion of cancer treatment in the Province (operating costs are $1.6 million).
- Construction will begin to expand the O'Leary Community Hospital to accommodate 10 additional long term care beds.
- More than $2 million will be added this year to the Provincial Drug Program.
- Increase funding of $480,000 to private nursing homes.
- Increase home and palliative care funding by $1.5 million.
- Increase in social assistance benefits by $900,000.
- Additional $800,000 provided to enhance our mental health delivery system.
- Additional $1.5 million to the Disability Supports Program.
- Additional funding of $3.1 million in health information technology to improve service quality and access to health information.
- Start up funding for respiratory research.

Education

Achievements

- Funding of School Board deficits of $1.1 million.
- Completion of school construction:

  Summerside/Miscouche French School;
  Parkdale School addition; and
  West Prince French School expansion.
- Miscouche Consolidated School addition is well underway.
- Increased funding to Atlantic Veterinary College by $418,500 for year one of a new five-year business plan.
- Funding to Holland College of $350,000 to support the operation of the Atlantic Welding and Fabrication Centre.
- Second successful year of the public-funded, community based kindergarten program.
- Contributed $100,000 to Holland College Foundation.

New Initiatives

- Continued increased funding of $1 million to both UPEI and Holland College.
- Maintaining the number of teaching positions despite declining enrollments (33 FTE teachers - $1.8 million).
- $100,000 to the Community Service Bursary Program.
- Second year funding to UPEI School of Nursing of $441,300.
- Renovation to Kinkora Regional High School.
- Implementation of new Math curriculum in public school system ($1 million).

Additional Funding

- Construction of a new Atlantic Technology Centre is underway with opening scheduled for the summer of 2002.
- Work on Rural IT Centres with openings in 2002-2003.
- Increase funding to Tourism Marketing of $500,000.
- New Visitor Information Centre for Wood Islands.
- Commitment of $382,000 to the Drinking Water Strategy to keep our water clear *"from the ground to the glass"*.
- Near completion of the East Prince Health Facility.
- Continuation of the Canada-PEI Municipal Infrastructure Program.
- Completion of the new North Cape Wind Farm Site, producing green power for Islanders.
- Funding for community access centres with the Federal Government.
- Continued commitment of $250,000 to the Lobster Science Centre at the Atlantic Veterinary College.
- Financial and technical support for on-farm conservation projects with total public and private investment of more than $10 million.

Summary Statistics

	2000	2001
Population on 1 July (in '000s)	138.1	138.5
Personal Income per capita* ($) *As % of Canadian personal* income	21,746 *80.5*	22,388[1] *80.7*[1]
Employment (in 000's)*	64.5	65.9
Unemployment Rate - PEI (%) *Unemployment Rate - Canada (%)*	12.0 *6.8*	11.9 *7.2*
CPI - Annual Change PEI (%) *CPI - Annual Change (%) Canada*	4.1 *2.7*	2.6 *2.6*
Retail Trade ($ millions)*	1,230.1	1,278.1
New Motor Vehicle Sales (units)*	4,902	4,635
Farm Cash Receipts ($ millions)*	321.9	335.6
Potato Receipts ($ millions)	154.9	126.0
Lobster Landings ($ millions) *Lobster Landings (lbs - millions)*	85.8 *19.0*	100.0 *18.9*
Housing Starts (units)	710	675
Investment ($ millions)*	549.3	566.0
Manufacturing Shipments ($ millions)*	1,183.1	1,202.1
Tourist Expenditures ($ millions)	280.0	310.0
International Exports in Goods ($ millions)*	682.9	657.8
GDP at Market Prices ($ millions)*	3,344	3,479[1]

* Revised Data

[1] Provincial Treasury estimate

Sources: Statistics Canada; CMHC;
PEI Fisheries, Aquaculture and Environment; Tourism PEI

BUDGET ADDRESS 2002

Province of Prince Edward Island
Budget Address
2002

Presented by
The Honourable Patricia J. Mella
Provincial Treasurer
and
Chair of Treasury Board

102-03930/

Prince Edward Island

2002 Budget

A Balanced Response to Difficult Times

Presented to
The Members of the Legislative Assembly of Prince Edward Island

by

Honourable Patricia J. Mella

Provincial Treasurer
and
Chair of Treasury Board

March 26, 2002

The full text of the Budget Address is available on the Internet at the Prince Edward Island Information Centre located at the following World Wide Web address:

http://www.gov.pe.ca/budget/

Files containing the Budget Address, associated tables and supporting materials are also available for download in Adobe Acrobat and Wordperfect formats at the same address.

PRINCE EDWARD ISLAND
2002 BUDGET

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THE BUDGET ADDRESS

A Balanced Response to Difficult Times

Madam Speaker, Members of the Legislative Assembly.

A year ago I presented the 2001 Budget the theme of which was *Keeping the Balance in Uncertain Times*. At that time there were troubling signs that the strong economic growth Canada had been enjoying in previous years was coming to an end. I noted that, "The distinct slowdown in the US economy, coupled with severe reductions in world stock markets have caused a serious reassessment of the economy."

Madam Speaker, using the best information available at that time we developed our Budget, predicated on this uncertain economic outlook. But no one could have foreseen the tragedy that overtook the world on September 11, 2001. This heinous act of terrorism went beyond all known bounds of humanity.

Casting our thoughts back to the events of that day and the months following, let us not forget the uncertainties and impacts resulting from:

- one, the immediate closure of airspace to the US and diversion of traffic to Canadian terminals;
- two, the obstruction to trade across the US border;
- three, the demands for and response to the need for increased security at airports and strengthened border controls;
- four, the decisions to target military forces on Afghanistan; and
- five, the uncertainty surrounding the success of these measures.

"... no one could have foreseen the tragedy that overtook the world on September 11, 2001. This heinous act of terrorism went beyond all known bounds of humanity."

It now looks as though the direct threat that was posed to our society has been successfully countered, although the effort continues. Also, the latest news points to encouraging signs that the North American economy is improving. However, the events of September 11 caused an immediate loss of air travel and a drop in business and consumer confidence. In the months following, the global economic climate became very clouded.

"In the months following, the global economic climate became very clouded."

Public Input

Madam Speaker, this has been a challenging Budget to prepare. I have, however, been helped in this task first, by my colleagues and second, by the advice of those who wrote and spoke to me during its preparation. As in previous years I invited members of the public and interest groups to advise me on their priorities, concerns and thoughts on the Budget. I am always encouraged by the interest demonstrated by many in the finances of the Province and their concern for the economic future of Prince Edward Island.

"Madam Speaker, this has been a challenging Budget to prepare."

We listen and learn from all the advice from every quarter concerning the Budget.

Madam Speaker, budgets are inherently about the efficient and effective use of the taxpayers' hard-earned dollars and as such they must reflect the needs of the people of the Province.

I must point out, however, that there are large elements of our fiscal situation that are beyond our control. Approximately 40 per cent of our revenues come from federal sources and hinge on the national economy, coupled with decisions and actions of the Federal Government. I will speak more of this later, but it will become evident through this discourse that the uncertainties surrounding federal transfers are the main reasons why this

"... the uncertainties surrounding federal transfers are the main reasons why this Budget has been so challenging."

Budget has been so challenging.

Economic and Fiscal Performance

Last year's Budget anticipated that the Canadian and Provincial economies would grow more slowly in 2001 compared to previous years. In fact, the GDP for Canada in 2001 expanded by only 1.5 per cent in constant dollars, compared to 4.4 per cent in the previous year. For Prince Edward Island we estimated growth of 1.3 per cent in 2001, which compares to 3.0 per cent in the previous year. The reduced pace of economic growth also slowed employment gains from the record 5.2 per cent increase we enjoyed in 2000, to 2.2 per cent in 2001.

"Madam Speaker, I am happy to be able to report that notwithstanding the slower pace of growth, there were approximately 66,000 Islanders employed in 2001, which is an all time high."

Madam Speaker, I am happy to be able to report that notwithstanding the slower pace of growth, there were approximately 66,000 Islanders employed in 2001, which is an all time high. The expansion in employment meant that an additional 1,400 persons were working last year. Unemployment fell to a low of 10.2 per cent in June 2001 resulting in an annual average of 11.9 per cent, the lowest since 1981.

Nationally, the slowing economy prompted the Bank of Canada to lower interest rates ten times from a high of 6 per cent to 2.25 per cent. By years' end interest rates were at their lowest in 40 years. This aggressive reduction in interest rates encouraged a sharp increase in consumer spending, with car sales being a major contributor. Further, during 2001 energy costs fell sharply, following their escalation last year.

"... the Province showed its determination to prove that the potato wart problem was isolated... Thanks to these efforts, our farmers were freed from the embargo in early 2001."

Reflecting on the economic performance of the Province during 2001, it may be recalled that our main concern at the outset of the year was the embargo on potato shipments to the United States. Working closely with the potato industry, the Province showed its determination to prove that the potato wart problem was isolated and we pressed the Federal Government to negotiate with the US

Government to lift the embargo on shipments. Thanks to these efforts, our farmers were freed from the embargo in early 2001.

Island farmers faced another serious problem in the subsequent crop year as near-drought conditions in the growing season resulted in a very small harvest, particularly the potato crop. The volume of potatoes was 39 per cent below the 2000 crop. This in turn caused potato processors to reduce the level of their production. Fortunately, improved potato prices, combined with the support programs provided by the federal and provincial governments to potato farmers in early 2001, permitted farm cash receipts to expand to $335.6 million in 2001, up from 2000 by 4.3 per cent.

"... insofar as the provincial economy goes, our forecast for 2001 at Budget time now appears to be reasonably on target."

The trade embargo hurt our exports, which were down by 3.7 per cent in 2001, following dramatic growth in previous years. Tourism did relatively well in 2001 going against the regional trend, with $310 million of expenditures, up by 10.7 per cent from last year.

Lobster landings reached $100 million in 2001, an all time high, although we did note that fish volumes were down somewhat.

Retail sales reached a record level of $1.3 billion, expanding by 3.9 per cent from the previous year. This was aided by the extremely low interest rates.

Madam Speaker, insofar as the provincial economy goes, our forecast for 2001 at Budget time now appears to be reasonably on target.

"I am happy to able to report that revenues in total have exceeded budget by $14.5 million."

A fuller explanation of the economy is contained in Budget Paper A. I will now turn to the fiscal outcome for the year 2001-2002.

Madam Speaker, the budgeted revenues for 2001-2002 were forecast to expand by only 1 per cent from their forecast levels of 2000-01. I am happy to able to report that revenues in total have

exceeded budget by $14.5 million.

In the 2001 Budget we had estimated that our own source revenues would be $545.8 million in 2001-2002. These are revenues that are derived from provincial taxes and other local sources. At $549.9 million, they are essentially on target.

Madam Speaker, the Federal Government provides provinces with revised estimates of their equalization entitlements twice a year. These federal estimates fluctuate widely from estimate to estimate with the result that we have learned to use our own information in an effort to more reliably predict our revenues and plan for the future. Only as recently as February 28, 2002 we were informed of significant differences in the previous numbers the Federal Government provided which contrasted with our forecast revenues. As it now stands, our original estimates are off by only 2.6 per cent.

"...our Government made it clear in late 2001 that efforts were needed to reduce the pace of spending,..."

On the expenditure side of the account, our Government made it clear in late 2001 that efforts were needed to reduce the pace of spending, in light of the evident slow growth in revenues. Following the second quarter review, line departments responded by reducing spending by $11 million. We also put in place a policy to freeze hiring with exceptions for hiring for essential services only.

Expenditures are now forecast to be $986.7 million, which exceed the original Budget by 2.8 per cent. I might add that this represents an increase of only 2.4 per cent from the spending limits in the previous year. Part of this increased spending is the result of the acceleration of the East Prince Health Facility construction.

"I am happy to report that, exclusive of the Province's investment in the East Prince Health Facility, the projected surplus for 2001-2002 is $4.9 million."

In view of the additional work on the Health Facility, involving $19.4 million of expenditures in 2001-2002, the overall forecast is a deficit of $14.5 million. I am happy to report that, exclusive of the Province's investment in the East Prince Health Facility, the

projected surplus for 2001-2002 is $4.9 million. This compares to a budgeted surplus of $11.6 million for the year. The difference of $6.7 million represents less than 1 per cent of our total budget.

Madam Speaker, I can assure you that this Government has been vigilant in its efforts to keep the lid on spending and in any other year the limited expenditure expansion that was allowed would have resulted in large surpluses. Additional investments were provided for priority reasons only.

"Madam Speaker, I can assure you that this Government has been vigilant in its efforts to keep the lid on spending..."

What are these priority areas? Government's priorities are the priorities of Islanders. Health costs are higher than Budget by $13.8 million, largely in view of the work on the East Prince Health Facility which, as I noted, is moving ahead faster than had been anticipated.

The Province acted on an opportunity to assist in a substantial expansion of the aerospace sector in Slemon Park, increased funding of $500,000 for Tourism Marketing and completed additional highway maintenance. Further, we also had to deal with the unanticipated School Boards deficits of $1,080,000.

Madam Speaker, this was the nature of our additional spending in 2001-2002. I would like to emphasize that when we complete our budget, we make our best estimates based on all available information. Actual results will vary from these estimates depending on events and circumstances that occur throughout the year. Variances from budget are not unusual and in fact can be expected.

"...there are some preliminary indications that the economic slump may have bottomed out."

Economic Outlook

I should now like to turn our attention to the future.

Fortunately, there are some preliminary indications that the economic slump may have bottomed out. The latest economic

statistics on the American and Canadian GDP indicate that the fourth quarter was not as weak as had been initially anticipated. More recently, the Governor of the Bank of Canada declared that the recovery is underway.

"...growth rates in 2001 and 2002 are very modest by comparison to the pace of growth that we had been experiencing from 1996 to 2000."

Madam Speaker, it would be imprudent to budget in anticipation of a major economic improvement in view of the present uncertainties. We hope that there will be progressively better news on the economy as the year unfolds, but the strength of the recovery is still the subject of speculation at the moment.

The December 2001 Federal Budget forecast that the national economy would expand by 1.1 per cent in 2002 and 3.9 per cent in 2003, following growth of only 1.5 per cent last year. For Prince Edward Island our forecast is for the economy to grow by about 1.2 per cent this year.

The important point to bear in mind is that growth rates in 2001 and 2002 are very modest by comparison to the pace of growth that we had been experiencing from 1996 to 2000. I might note that as recently as October 2000 the Federal Government was anticipating sustained economic expansion of 3 to 3.5 per cent per year in 2001 and 2002. The fiscal consequence of the reduced rate of economic expansion means that our flexibility in 2002 is somewhat compromised.

"The fiscal consequence of the reduced rate of economic expansion means that our flexibility in 2002 is somewhat compromised."

Fiscal Outlook

Madam Speaker, we now believe that the slow level of revenue growth that occurred in 2001-2002 will turn into a decline in 2002-2003, with resulting difficult fiscal consequences. The Budget for 2003 shows that revenues will be less than the previous year by $3.8 million.

"The Budget for 2003 shows that revenues will be less than the previous year by $3.8 million."

The main reason for this situation is a decline of federal revenues by $34 million in 2003, from our forecast revenues in 2002.

By contrast, our own-sourced revenues, generated from the taxes we receive on sales, personal income and property are expected to grow with the economy.

Federal revenue performance is weak for a variety of reasons, and there is added uncertainty in the coming year over exactly what can be expected.

"Federal revenue performance is weak for a variety of reasons..."

Madam Speaker, Members may recall that in January of this year provinces were unexpectedly informed of the misallocation of federal income tax to some provinces that resulted from a federal accounting error in the administration of capital gains tax from Mutual Fund Trusts. We were informed that this resulted in an estimated overpayment of Equalization to us of some $6 million. Madam Speaker, we still have received no indication of how this will impact on our Equalization in the coming year. In the 2001 Federal Budget the Government of Canada committed $2 billion to an infrastructure program. Madam Speaker, we still have no information on how this is to be distributed although we are committed to working with our federal counterparts. Most of our regional economic development agreements have now expired, but Madam Speaker, we still do not know when and by how much they will be renewed.

The population numbers from the 2001 Census have just been released, and Madam Speaker, they also have potentially large impacts on major federal transfers.

"All Provincial Premiers and Ministers of Finance have called on the Federal Government to remove the ceiling on Equalization and to strengthen the program..."

On top of these challenges, all provinces continue to have serious disagreements with our federal friends over the ceiling on Equalization and the inadequacy of the CHST transfer. I should note that in 2001 I appeared before both the House of Commons Finance Committee and the Senate Finance Committee to explain why the Equalization program is deficient. All Provincial Premiers and Ministers of Finance have called on the Federal Government to remove the ceiling on Equalization and to strengthen the program, and to raise their transfers in support of

Health, Education and Social Services, through the CHST transfer.

More details on these concerns can be found in Budget Paper B.

Madam Speaker, our CHST cash in 2002-2003 will be about $89 million which is an increase of approximately 2.8 per cent over last year, however, our expenditures on health are growing in excess of 7 per cent per year. CHST funding is still below the level of support we received some eight years ago in 1994-95. We estimate that our Equalization payments will be considerably below their 2001-2002 level and that calculation is highly uncertain. Still, the Federal Government insists on applying a ceiling to payments. In addition, other federal transfers are clouded in uncertainty.

"CHST funding is still below the level of support we received some eight years ago in 1994-95."

Madam Speaker, I trust that Members of this House and the public will understand the issues that confront the Government in the preparation of this most challenging Budget.

"In view of the weak revenue picture for 2002-2003 we must budget prudently while maintaining our commitments."

The Year Ahead

In view of the weak revenue picture for 2002-2003 we must budget prudently while maintaining our commitments. Although we will depart from our goal of a balanced budget for 2003, we have every expectation to return to a balanced situation in 2004.

As we announced earlier this year, when we began the Budget exercise we realized that the shortfall in revenues and the underlying growth in expenditures created a projected deficit of an unacceptable level. This was our starting position.

"Although we will depart from our goal of a balanced budget for 2003, we have every expectation to return to a balanced situation in 2004."

Through the course of developing this Budget we have acted to pare down spending drastically. In the course of the Budget exercise we adhered to the principle that delivery of essential services will continue, and that we recognize our responsibility to

our employees and will honour the salary settlements established through contract negotiations recently concluded.

In responding to the challenge of the difficult times, we have set overall spending in 2002-2003 at a level only 1.4 per cent higher than the forecasted expenditures of the previous year.

The overall excess of revenues and expenditures in the coming fiscal year will produce a deficit of $11.6 million before the Province's investment in the East Prince Health Facility and a deficit of $28.8 million subsequent to the investment. Madam Speaker and Members of this House, this represents a significant improvement from the deficit that we faced at the start of the Budget exercise. Generally, governments will run deficits during economic slowdowns because revenues are lower than normal. When this occurs, it is referred to as a cyclical deficit which governments believe will be eliminated as economic conditions improve.

"... will produce a deficit of $11.6 million before the Province's investment in the East Prince Health Facility and a deficit of $28.8 million subsequent to the investment."

Tax Measures

Madam Speaker, we have resisted general tax increases with the exception of two tax measures which I will announce in this Budget.

As of midnight tonight, the Health Tax will be raised by $5 per carton of 200 cigarettes and proportionate increases will be raised on related tobacco products.

"As of midnight tonight, the Health Tax will be raised by $5 per carton of 200 cigarettes and proportionate increases will be raised on related tobacco products."

This measure follows similar steps in other provinces, the primary aim of which is to act as a further disincentive to smoking. Prince Edward Island will be among the forefront of provinces aggressively acting on cigarette smoking as we previously raised the tax in April and December of last year.

The tax on gasoline will increase by 1 cent per litre as of midnight tonight. An analysis of the most recent prices across Canada

shows Prince Edward Island prices to be among the lowest in Canada, lower than the Canadian average and the lowest in Atlantic Canada.

Priorities for 2002-2003

Madam Speaker, few could disagree that the development of this Budget was undertaken in an extraordinary period of global uncertainty.

"The tax on gasoline will increase by 1 cent per litre as of midnight tonight."

Notwithstanding the problems that beset the economy, the most difficult aspect of this has been the volatile nature of the revenues delivered through the federal system. This not only includes Equalization and CHST but also the federal share of development funds, infrastructure monies and the Personal and Corporate Income Tax , all of which are administered federally. The ability of the federal system to provide reliable and accurate forecasts of our receipts is sadly lacking.

Bearing in mind the overall revenue decline within which we are working in 2002-2003, some reductions in spending have been necessary.

"The ability of the federal system to provide reliable and accurate forecasts of our receipts is sadly lacking."

Overall, expenditures have been reduced by $39.5 million in 2002-2003 from the Status Quo Budget. This represents a reduction of 4 per cent in overall spending. The reductions come from a wide variety of programs and services across all departments.

The largest reduction is in our Highways Budget from which $12.5 million in planned capital spending has been delayed.

"Overall, expenditures have been reduced by $39.5 million in 2002-2003 from the Status Quo Budget."

The second most significant reduction is in the Education Capital Budget, which is reduced by $5.2 million. The construction of the Summerside Intermediate and Bluefield Phase II schools will be delayed, however, our Government is committed to the completion of these projects as soon as revenues permit. I must

emphasize, however, that other school construction programs will proceed as planned. The Kinkora School is proceeding as scheduled. I should note that we have already completed the Parkdale School addition, the Summerside/Miscouche French School and the West Prince French School. The Miscouche Consolidated School addition project is also well underway.

We are holding fast to our commitment to bring MRI and Linear Accelerator services to the Province. Our Government will make investments of $9.6 million in the fiscal year to support their capital costs as well as $1.6 million to fund the start up costs of these important services. We have already recruited a highly respected radiation oncologist to develop this much needed service.

"We are holding fast to our commitment to bring MRI and Linear Accelerator services to the Province."

We will also begin the planned expansion of the O'Leary Community Hospital, budgeted at $1.1 million this year.

We have introduced a voluntary workforce adjustment program in an effort to reduce costs and streamline the delivery of services. The projected savings of $3.75 million will assist in the renewal of the Provincial Government workforce.

Madam Speaker, I could go on and provide more details of the reductions to our spending plans that were necessary this year but would prefer to leave this to the respective departmental Ministers who are more knowledgeable than I am on their programs.

"We have introduced a voluntary workforce adjustment program in an effort to reduce costs and streamline the delivery of services."

Improved Services

Madam Speaker, I would like to discuss the large improvements in our public service that our Government continues to achieve.

Last year more than 45 new registered nurses began work here. Overall we now have 1,411 nurses, compared to 1,364 a year ago. We were able to recruit 8 family physicians and 12 specialists. During 2001, each of our Health Regions were awarded

maximum accreditation status by the Canadian Council on Health Services Accreditation. We have provided an additional $2 million to provincial drug programs, largely the Seniors and Financial Assistance Program. We have increased funding to private nursing homes over the past four years and will increase funding by a further $480,000 in 2002-2003.

An additional $1.5 million is provided to home and palliative care, and a further $1.5 million for the Disability Supports Program.

Madam Speaker, the Government is resolute in its desire to carry forward its commitments despite the difficult financial pressures that exist. The largest investment in 2002-2003 is the East Prince Health Facility whose pace of construction is ahead of schedule. We have budgeted $21 million for this project, which we now expect to be near completion by April 2003.

Education and training are the cornerstones of the future development of the Province. Our Government has maintained 33 teaching positions despite declining enrollments. During 2001-2002, initiatives were taken to improve literacy in both French and English. Last year was the second year of the publicly-funded community based kindergarten program. Significant investments were made by the Province to support facilities and students at Holland College, UPEI, the Atlantic Veterinary College, and the UPEI School of Nursing. This Budget allows for those continued investments.

Madam Speaker, the agriculture and food industry of the 21st century will be transformed significantly by ongoing developments in science and technology, the adoption of new economic opportunities from innovative agriculturally-based products, and growing consumer demand for safe, high quality products produced in an environmentally responsible manner. Helping new and existing producers acquire the skills, knowledge and tools they need is a priority of this Government.

"Madam Speaker, the Government is resolute in its desire to carry forward its commitments despite the difficult financial pressures that exist."

"The largest investment in 2002-2003 is the East Prince Health Facility whose pace of construction is ahead of schedule."

"Education and training are the cornerstones of the future development of the Province."

FarmNet, a new web-based service, is being developed with the involvement of all sectors of the industry as a long-term, broad-based and multi-faceted approach to connectivity, skills development and for integrating information and communication technology into new and existing farm business practices.

Over the past three years under the Agriculture and Environmental Resources Conservation program, a total of upwards of $6.5 million was provided for on-farm conservation projects. Given the success of this three-year initiative, a new program will be developed to improve the sustainability and productivity of agricultural operations.

"Madam Speaker, the agriculture and food industry of the 21st century will be transformed significantly by ongoing developments in science and technology..."

The Department of Agriculture and Forestry is also working with several interested organizations to examine options for a Model Forest program for Prince Edward which would bring people together to create a shared vision for Island forests and develop strategies to enhance the many timber and non-timber benefits they provide. To this end, the Department is also working closely with the Public Forest Council to increase awareness of the Island's public forest lands and the non-timber potential of these lands.

Madam Speaker, our drinking water is one of our most precious assets. Last year we committed $270,000 to a long-term Drinking Water Strategy. This year we are committing $382,000 to protect our water for present and future generations.

"Madam Speaker, our drinking water is one of our most precious assets."

The Province will sustain its commitment of $250,000 per year to the Lobster Science Centre at the Atlantic Veterinary College and provide additional resources for further research into this, one of our most important primary resources.

During 2002 the provincial Department of Fisheries, Aquaculture and Environment in partnership with the PEI Aquaculture Alliance and the Aquaculture Association of Canada, will host

Aquaculture 2002, the largest annual event of its kind in Canada.

Communities

Strong and vibrant communities contribute to the overall success of our Island economy. Our Government continues to promote and invest in economic initiatives to build and sustain our communities. Notre gouvernement continue à supporter et investir dans des initiatives économiques pour soutenir le développement de nos communautés. The Community Development Bureau will partner with Island communities to develop local projects.

"Notre gouvernement continue à supporter et investir dans des initiatives économiques pour soutenir le développement de nos communautés."

Conclusion

Madam Speaker, the theme of this budget is "A Balanced Response to Difficult Times". It is an honest assessment of the impact on the Province's economy and fiscal position of the economic downturn that overtook the nation in 2001. It is a temporary but responsible departure from our long-standing goal of balancing our accounts, reducing taxes and lowering the debt.

The legacy we leave our children cannot be debt covered by deficits. We know we must invest in the future and not allow short-term challenges to take us from our long-term goals.

The future of Prince Edward Island is dependent on the dedicated people who share our commitment to make this province a better place to live.

"This Budget keeps the Province on its course notwithstanding the difficult times that we are passing through."

This Budget keeps the Province on its course notwithstanding the difficult times that we are passing through.

Madam Speaker, we will continue to take a balanced approach and focus on clear public priorities which will lead to balanced results. I believe this budget clearly articulates that approach and focus.

BUDGET SCHEDULES

1. Budget Summary

2. Gross Revenue

3. Gross Expenditure

4. Capital Revenue and Expenditure

5. Cash Requirements

6. Where the Money Comes From

7. Where the Money Goes

8. Historical Financial Statistics, Prince Edward Island, 1999/00 to 2002/03

9. Summary Comparison - Provincial Tax Rates

10. Federal and Provincial Personal Income Tax Rates

Schedule 1
Budget Summary

	2002-03 Budget Estimate $	2001-02 Forecast $	2001-02 Budget Estimate $
REVENUES			
Provincial Source	585,418,100	549,965,900	545,781,900
Federal Source	366,094,000	399,915,600	389,976,600
Capital	726,000	775,700	425,000
Sinking Fund Earnings	16,175,000	21,550,000	21,550,000
Total Revenues	968,413,100	972,207,200	957,733,500
EXPENDITURES			
Program Expenditures	857,105,400	830,251,300	808,181,000
Interest Charges on Debt	106,500,000	106,100,000	108,971,700
Capital Expenditures	16,381,000	30,980,200	28,980,200
Total Expenditures	979,986,400	967,331,500	946,132,900
SURPLUS (DEFICIT) BEFORE INVESTMENT IN EXTRAORDINARY CAPITAL PROJECT AND SPECIAL ADJUSTMENTS	(11,573,300)	4,875,700	11,600,600
EXTRAORDINARY CAPITAL PROJECT AND SPECIAL ADJUSTMENTS			
East Prince Health Facility	21,000,000	19,424,000	13,000,000
Pension Adjustment	-	-	(3,000,000)
Workforce Renewal Program	(3,750,000)	-	-
Total Adjustments	17,250,000	19,424,000	10,000,000
(INCREASE)/DECREASE IN NET DEBT	(28,823,300)	(14,548,300)	1,600,600

Schedule 2
Gross Revenue

	2002-03 Budget Estimate $	2001-02 Forecast $	2001-02 Budget Estimate $
PROVINCIAL OWN SOURCE			
Taxes	488,134,000	452,899,100	451,702,700
Investments	13,705,800	12,440,300	12,414,200
Fees and Services	38,392,800	39,573,000	38,250,000
Licenses and Permits	15,811,700	16,892,100	15,101,700
Sales	29,373,800	28,161,400	28,313,300
Sub-Total	585,418,100	549,965,900	545,781,900
GOVERNMENT OF CANADA			
Equalization Entitlement	255,000,000	282,304,000	275,000,000
Canada Health and Social Transfer Entitlement	89,086,000	86,648,000	87,755,000
Canada Employment	3,552,000	3,552,000	3,552,000
Infrastructure Works Program	2,734,000	3,750,000	2,146,000
Young Offenders Services	2,292,600	2,292,600	2,292,600
Housing Programs	2,030,600	2,130,000	2,070,100
Minority and Second Language	2,009,000	4,959,000	4,959,000
French Services Agreement	1,403,000	1,635,500	1,642,500
Other	7,986,800	12,644,500	10,559,400
Sub-Total	366,094,000	399,915,600	389,976,600
TOTAL CURRENT REVENUE	951,512,100	949,881,500	935,758,500
CAPITAL REVENUE	726,000	775,700	425,000
SINKING FUND EARNINGS	16,175,000	21,550,000	21,550,000
GROSS REVENUE	968,413,100	972,207,200	957,733,500

Schedule 3
Gross Expenditure

	2002-03 Budget Estimate $	2001-02 Forecast $	2001-02 Budget Estimate $
CURRENT			
Agriculture and Forestry	30,248,400	32,228,900	32,821,900
P.E.I. Grain Elevators Corporation	165,000	165,000	165,000
Community and Cultural Affairs	20,104,100	21,862,700	18,276,700
Development and Technology	6,267,900	7,761,800	6,715,200
Technology Asset Management.	1,876,400	1,631,000	1,631,000
Prince Edward Island Business Development Inc.	30,022,000	29,139,100	28,439,300
Employment Development Agency	3,288,900	5,258,500	3,692,700
P.E.I. Energy Corporation	723,400	600,100	730,200
Education	201,923,700	200,345,200	199,133,000
Island Regulatory and Appeals Commission	1,065,100	1,065,100	1,065,100
Office of the Attorney General.	29,739,800	30,094,900	29,342,200
Executive Council	3,180,300	3,150,800	2,855,500
Tourism	108,900	97,000	163,600
Tourism PEI	11,333,100	11,702,800	10,744,600
Health and Social Services	389,174,200	352,302,100	344,867,400
Legislative Assembly	3,101,800	3,102,700	3,102,700
Provincial Treasury	18,778,500	18,685,300	19,047,500
Council of Maritime Premiers	183,700	183,700	183,700
General Government	8,074,600	7,704,800	7,569,900
Interministerial Women's Secretariat	299,700	344,700	345,300
P.E.I. Lending Agency.	790,700	733,900	811,700
Fisheries, Aquaculture and Environment	8,255,300	9,347,200	8,082,700
Transportation and Public Works	69,430,300	71,083,300	71,108,500
Auditor General	1,229,600	1,221,700	1,263,700
P.E.I. Public Service Commission	6,395,800	5,302,500	5,283,800
Employee Benefits	11,344,200	15,135,900	10,738,100
PROGRAM EXPENDITURE	**857,105,400**	**830,251,300**	**808,181,000**
Interest Charges on Debt	106,500,000	106,100,000	108,971,700
Capital Expenditures	16,381,000	30,980,200	28,980,200
TOTAL EXPENDITURE	**979,986,400**	**967,331,500**	**946,132,900**
East Prince Health Facility	21,000,000	19,424,000	13,000,000
GROSS EXPENDITURE	**1,000,986,400**	**986,755,500**	**959,132,900**

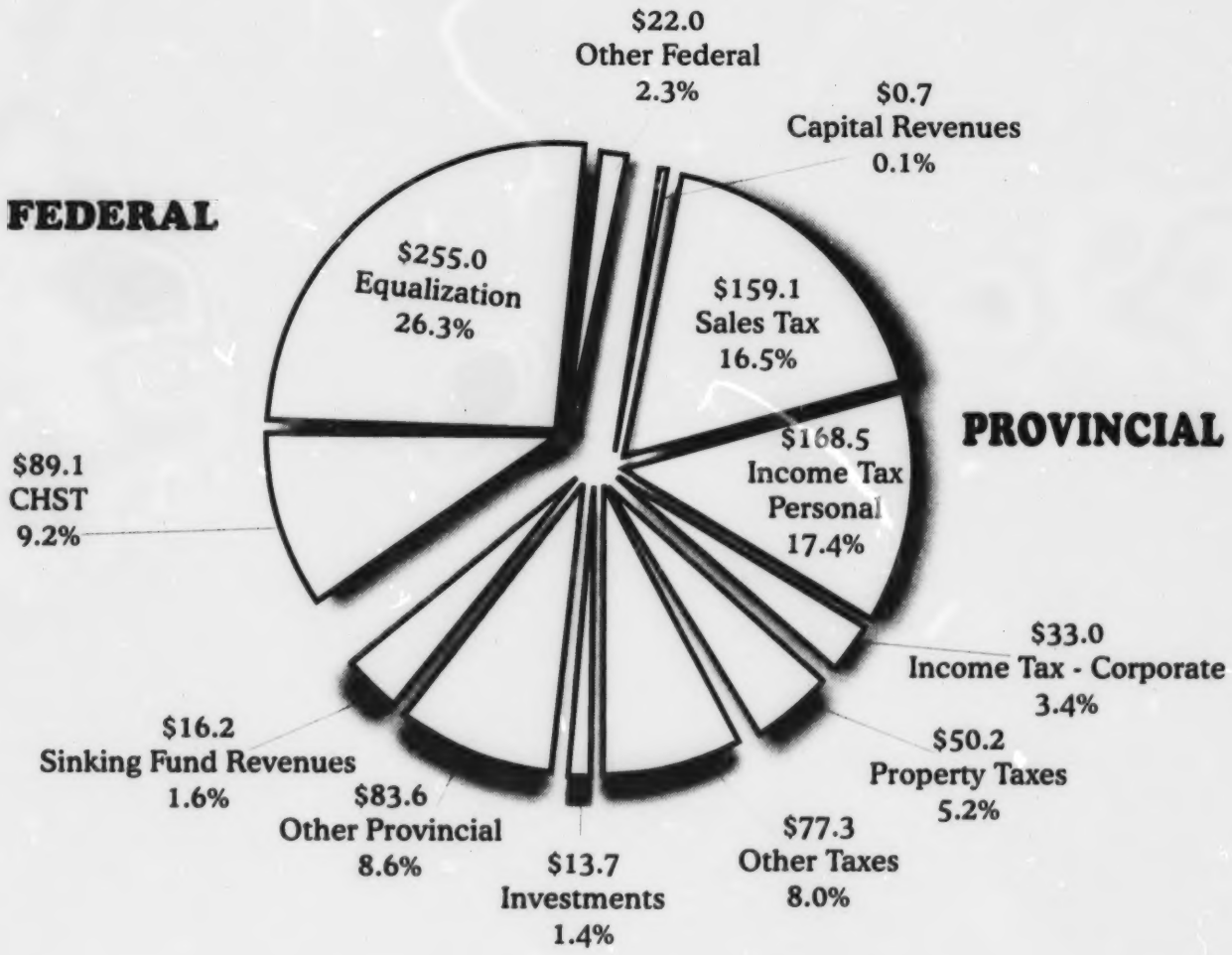
Schedule 4
Capital Revenue and Expenditure

	2002-03 Budget Estimate $	2001-02 Forecast $	2001-02 Budget Estimate $
REVENUE			
Land	146,000	295,000	295,000
Miscellaneous	580,000	480,700	130,000
Total Capital Revenue	**726,000**	**775,700**	**425,000**
EXPENDITURE			
Highways	14,000,000	28,867,300	25,997,400
Buildings	2,381,000	2,112,900	2,982,800
Total Capital Expenditure	**16,381,000**	**30,980,200**	**28,980,200**
NET CAPITAL EXPENDITURE	**15,655,000**	**30,204,500**	**28,555,200**

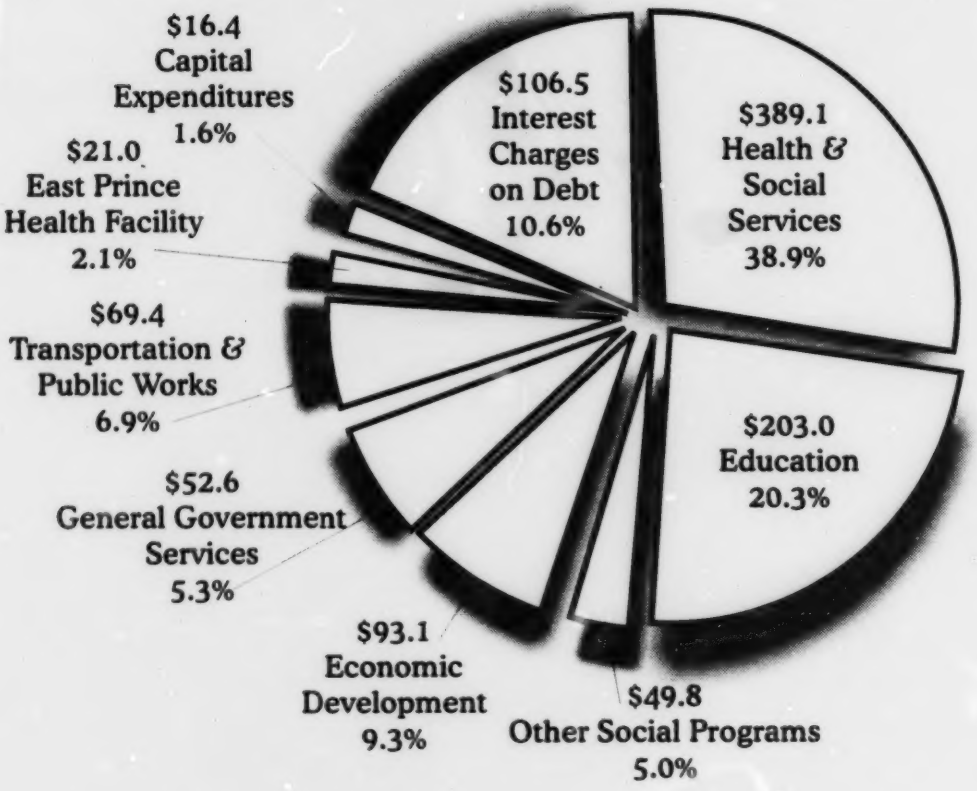
Schedule 5
Cash Requirements

	2002-03 Budget Estimate ('000 $)	2001-02 Forecast ('000 $)	2001-02 Budget Estimate ('000 $)
CASH REQUIREMENTS			
Net Lending to Crown Corporations	62,300	46,600	30,900
Budgetary (Surplus)/Deficit	28,800	14,500	(1,600)
Sinking Fund Earnings	16,200	21,500	21,500
Sinking Fund Provisions	11,700	10,800	11,100
Non Cash Item - Pension Plan Adjustment	-	-	3,000
Federal Loans	1,000	1,200	1,200
Maturing Debt			
Canada Pension Plan	11,400	11,500	11,500
Public Debentures	48,900	44,800	13,500
Capital Lease	-	21,700	21,700
Provincial Deposit Receipts	15,000	33,000	-
Transfer to Pension Funds	18,000	-	-
	213,300	205,600	112,800
SOURCES OF CASH			
Canada Pension Plan Borrowing	11,400	11,400	11,500
Short-term Borrowing	53,000	27,700	1,100
Long-term Borrowing	100,000	100,000	65,000
Sinking Fund			
- for debenture maturities/callables	48,900	44,800	13,500
- for capital lease	-	21,700	21,700
	213,300	205,600	112,800

Schedule 6
Where the Money Comes From
2002-2003
($ millions)



Schedule 7
Where the Money Goes
2002-2003
($ millions)



Schedule 8

Historical Financial Statistics, Prince Edward Island 1999/00 to 2002/03

($ million)

	99/00	00/01	01/02	02/03
Revenues				
Provincial Source	519.0	544.3	550.0	585.4
Federal Source	352.9	383.5	399.9	366.1
Capital	5.3	1.1	0.7	0.7
Sinking Fund Earnings	23.2	22.8	21.6	16.2
Total Revenues	**900.4**	**951.7**	**972.2**	**968.4**
Expenditures				
Program Expenditures	751.0	820.3	830.3	857.1
Interest Charges on Debt	102.7	107.7	106.1	106.5
Capital Expenditures	45.6	29.3	30.9	16.4
Total Expenditures	**899.3**	**957.3**	**967.3**	**980.0**
Surplus (Deficit) Before Investment In Extraordinary Capital Project and Special Adjustments	1.1	(5.6)	4.9	(11.6)
Extraordinary Capital Project and Special Adjustments				
Pension Adjustment	(2.5)	0.1	-	-
Workforce Renewal Program	-	-	-	(3.8)
Capital Lease	6.4	-	-	-
Reclassified Loan	2.6	-	-	-
East Prince Health Facility	-	5.9	19.4	21.0
Total Adjustments	**6.5**	**6.0**	**19.4**	**17.2**
INCREASE IN NET DEBT	**5.4**	**11.6**	**14.5**	**28.8**
Net Debt				
Net Debt, Beginning of Year	990.4	1024.3	1035.9	1050.5
Employee Benefits Accrual	28.5	-	-	-
Budgetary Deficit	5.4	11.6	14.5	28.8
Net Debt, End of Year	**1024.3**	**1035.9**	**1050.4**	**1079.3**

Schedule 9
Summary Comparison - Provincial Tax Rates [1,2]

	Sales Tax (%)	Tobacco Tax ($/pk 25)	Fuel Tax Gasoline (¢/litre)	Fuel Tax Diesel (¢/litre)	Corporate Tax General [3] (%)	Corporate Tax Small (%)
British Columbia	7.5	3.75	11.0	11.5	13.5	4.5
Alberta	-	4.00	9.0	9.0	13.0	4.5
Saskatchewan	6.0	2.15 [4]	15.0	15.0	17.0	6.0
Manitoba	7.0	2.40 [4]	11.5	10.9	16.5	5.0
Ontario	8.0	1.11 [4]	14.7	14.3	12.5	6.0
Quebec	7.5	1.64	15.2 [4]	20.2 [4]	16.3	8.9
New Brunswick	8.0	1.81 [4]	13.0 [4]	13.7 [4]	16.0	4.0
Nova Scotia	8.0	2.00 [4]	13.5 [4]	15.4 [4]	16.0	5.0
Newfoundland	8.0	3.38 [4]	16.5 [4]	16.5 [4]	14.0	5.0
Prince Edward Island	**10.0**	**2.86**	**14.0**	**13.5**	**16.0**	**7.5**
Atlantic Average	8.5	2.36	14.3	14.8	15.5	5.4
National Average	7.8	2.45	13.3	14.0	15.1	5.6

1 For personal income tax rates and thresholds see Schedule 10.
2 PEI rates are effective as of March 27; Alberta's corporate tax is effective April 1; other rates are as of March 22, 2002.
3 Prince Edward Island, Newfoundland, Ontario and Saskatchewan have special rates for manufacturers and processors.
4 Excludes applicable provincial sales tax.

Schedule 10
Federal and Provincial Personal Income Tax Rates, Thresholds and Surtaxes - 2002 [1]

	Tax Rates (%)	Thresholds	Surtax Rates (%)	Surtax Thresholds
Federal	16.0	$7,634 – 31,677		
	22.0	31,678 – 63,364		
	26.0	63,365 – 103,000		
	29.0	103,000 and over		
Newfoundland	10.57	$7,410 – 29,590	9	$7,032
	16.16	29,591 – 59,180		
	18.02	59,181 and over		
Prince Edward Island	**9.8**	**$7,412 – 30,754**	**10**	**$5,200**
	13.8	**30,755 – 61,509**		
	16.7	**61,510 and over**		
Nova Scotia	9.77	$7,231 – 29,590	10	$10,000
	14.95	29,591 – 59,180		
	16.67	59,181 and over		
New Brunswick	9.68	$7,634 – 31,677		
	14.82	31,678 – 63,354		
	16.52	63,354 - 103,000		
	17.84	103,001 and over		
Ontario	6.05	$7,686 – 31,893	20	$3,685
	9.15	31,894 – 63,786	36	4,648
	11.16	63,787 and over		
Manitoba	10.9	$7,412 – 30,544		
	15.4	30,545 – 65,000		
	17.4	65,001 and over		
Saskatchewan	11.25	$8,000 – 30,000		
	13.25	30,001 – 60,000		
	15.50	60,001 and over		
Alberta	10.0	$13,339 and over		
British Columbia	6.05	$8,168 – 31,124		
	9.15	31,125 – 62,249		
	11.70	62,250 – 71,470		
	13.70	71,471 – 86,785		
	14.70	86,786 and over		

[1] PEI rates and thresholds are effective January 1, 2002; other provincial rates and thresholds as of March 20, 2002.

BUDGET PAPER A:

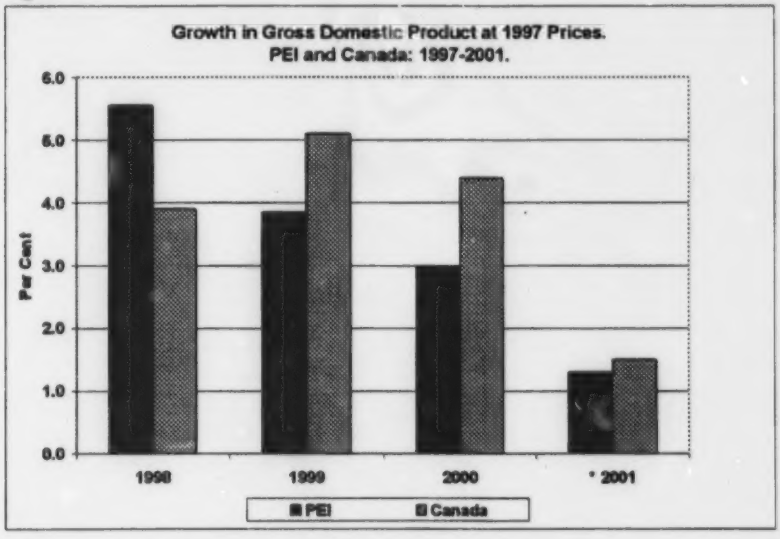
BACKGROUND NOTES ON THE ECONOMY

BUDGET PAPER A:
BACKGROUND NOTES ON THE ECONOMY

Provincial Highlights 2001

- Based on available statistics for Prince Edward Island in 2001, the Provincial Treasury estimates that the economy grew by 1.3 per cent, as measured by constant dollar Gross Domestic Product. This compares with a national growth rate of 1.5 per cent. Economic growth in 2001 was highlighted by increased employment, a buoyant construction sector and rising personal income. As seen in Figure A.1, this is the fourth year of continued economic expansion on Prince Edward Island, albeit at a slower rate than during the previous three years.

Figure A.1



Source: Statistics Canada, Canadian Economic Observer.
** PEI 2001 Provincial Treasury forecast.*

- Employment on Prince Edward Island expanded by 2.2 per cent in 2001 to average 65,900. This follows exceptional employment growth in 2000, when Prince Edward Island led the nation with employment growth of 5.2 per cent.

- Total labour income grew by 4.5 per cent to value $1,809 million in 2001, compared with national growth of 4.2 per cent.

- The value of manufacturing shipments on Prince Edward Island in 2001 showed a modest increase of 1.6 per cent to value $1,202 million, after growing at an average annual rate of 15 per cent since 1996.

- The value of international exports of goods declined by 3.7 per cent to value $657.8 million. While the value of international exports of frozen food products increased by 15.2 per cent, the increase was more than offset by declines in the value of processed fish products and raw potatoes.

- Total farm cash receipts improved by 4.3 per cent in 2001, to value $335.6 million.

- Trade disputes with the United States over potatoes and mussels were resolved.

- Dry weather conditions during the summer of 2001 resulted in a 39 per cent decline in the harvested potato volume estimated at 17,820,000 cwt.

- Preliminary estimates indicate that the value of all fish landings rose by 6 per cent to $145 million in 2001. Higher lobster prices increased the value of the lobster catch to an all-time high of $100 million.

- Tourism expenditures for 2001 were estimated at $310 million, an increase of 10.7 per cent over the previous year.

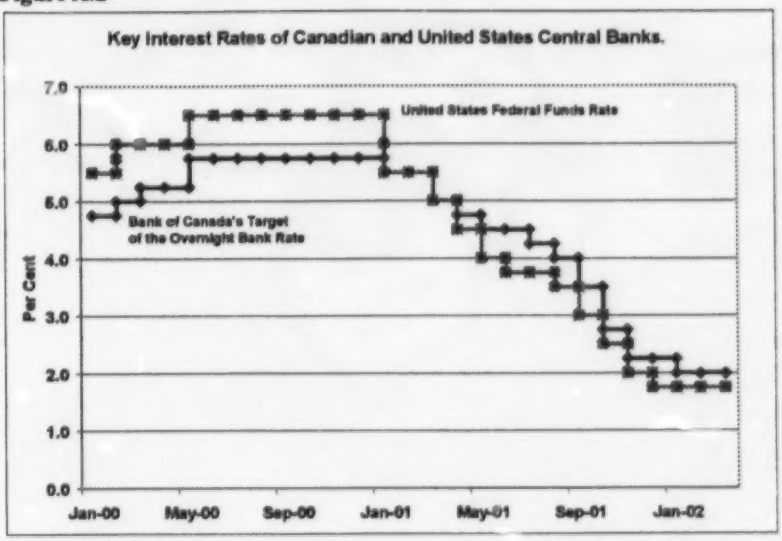
National and International Review

The Canadian economy posted strong growth in 2000, though slowing in the final months in line with the apparent slowdown in the United States. Canada's economy weakened through the first half of 2001 and contracted during the third quarter, marking an end to 37 consecutive quarters of growth in the Canadian economy. The worsening economic situations in Canada and the United States were further shaken by the events that occurred on September 11.

The economic slowdown that began in the United States quickly spilled over into Canada and to other countries, resulting in a global downturn. The main factors affecting the economic slowdown were the correction in the high-technology sector and the lagged impact of high energy prices. These factors were compounded by negative impacts of the September 11 terrorist attacks and associated disturbances. The OECD estimates that these combined factors caused total output from OECD member countries to contract during the second half of 2001 for the first time in 20 years.

GDP growth in the European Union also weakened considerably during 2001, reflecting sluggish trade and business investment, reduced demand for capital goods and a decline in exports.

Figure A.2



Source: Bank of Canada and United States Federal Reserve.

In response to the worsening economic situation the monetary authorities in Canada and in the United States began to take action early in 2001. Figure A.2 shows the rapid reductions made by the Bank of Canada and the US Federal Reserve to their key lending rates. Beginning in January of 2001 the Bank of Canada began lowering the target for the overnight bank rate from 5.75 per cent on January 22, 2001 to 2.00 per cent on January 15, 2002. This is the lowest rate since September of 1960.

The low Bank Rate has reduced mortgage rates and the cost of consumer credit, which has spurred new home construction. New automobile sales were also stimulated by attractive rebates and other incentives.

Motor vehicle sales in Canada improved by 11.9 per cent in the fourth quarter to cap a record year for car sales in Canada. Residential investment in Canada increased by 15.4 per cent in the fourth quarter and 11.2 per cent for the year. Additional government spending on national security to combat terrorism provided a measure of fiscal stimulus in the fourth quarter of 2001.

Overall government and business investment growth slowed to 1.4 per cent in 2001 compared to 8.7 per cent the previous year.

The improvement in the Canadian economy during the final quarter of 2001, raised growth for the year to 1.5 per cent. But overall economic growth for Canada in 2001 was the weakest since 1992.

The Canadian exchange rate with the US dollar hit a record low of 62.02 cents on January 18, 2002.

Employment in Canada expanded by an average of 1.1 per cent during 2001.

The US economy rebounded by 1.4 per cent in the fourth quarter to achieve annual growth in 2001 of 1.2 per cent. This compares to growth of 4.1 per cent in 2000.

The Bank of Canada estimates that the Canadian economy will grow by 1.5 per cent in 2002. The Gross Domestic Product for Canada is forecast to grow by between 1 to 2 per cent during the first half of this year and between 3 to 4 per cent during the second half, with further strengthening in 2003.

> *"Recent economic indicators for Canada show that the worst of the downturn is over. A recovery is underway."*
>
> *Governor of the Bank of Canada*
> *David Dodge, March 12, 2002.*

> *"The recent evidence increasingly suggests that an economic expansion is already underway, although an array of influences unique to this business cycle seems likely to moderate its speed."*
>
> *United States Federal Reserve Chairman*
> *Allan Greenspan, March 7, 2002.*

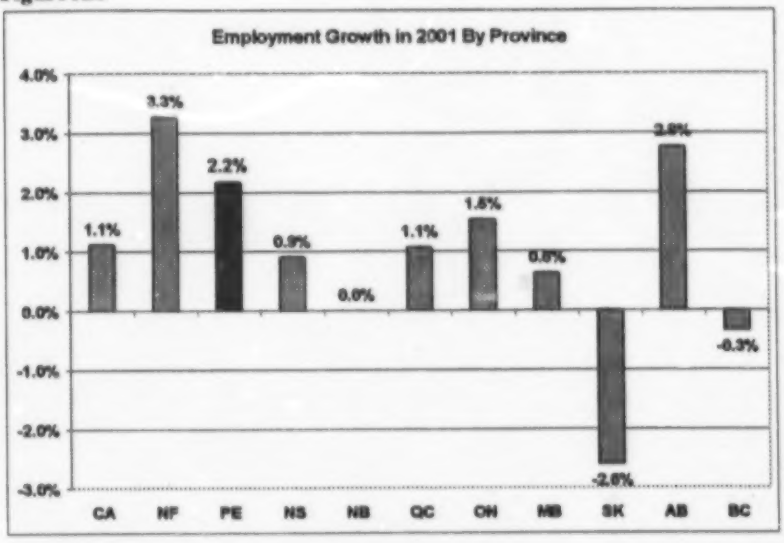
The Prince Edward Island Economy

The value of Prince Edward Island's Gross Domestic Product at market prices for 2001 is estimated to be $3,479 million. This represents growth in constant dollar GDP of 1.3 per cent. Growth in the Prince Edward Island economy in 2001 was highlighted by continued expansion in employment, a buoyant construction sector and a rise in personal income.

Employment

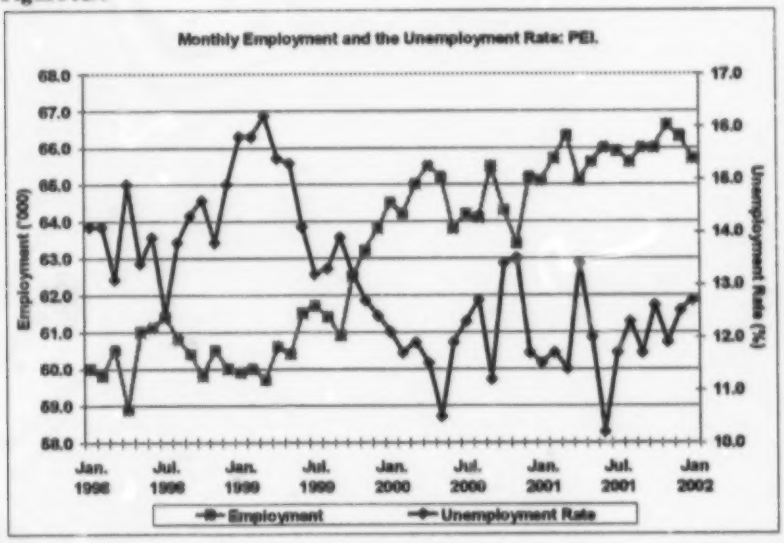
The number of employed people on Prince Edward Island continued to expand in 2001 by 2.2 per cent to average 65,900 for the year. This represents an increase of 1,400 employed people to the Island labour force. As can be seen in Figure A.3 Prince Edward Island was a leader in provincial employment growth in 2001. This follows the extraordinary increase in employment of 5.2 per cent recorded in 2000.

Figure A.3



Source: Statistics Canada, Labour Force Survey.

Figure A.4



Source: Statistics Canada, Labour Force Survey.

Employment growth reduced the unemployment rate to an average rate of 11.9 per cent in 2001.

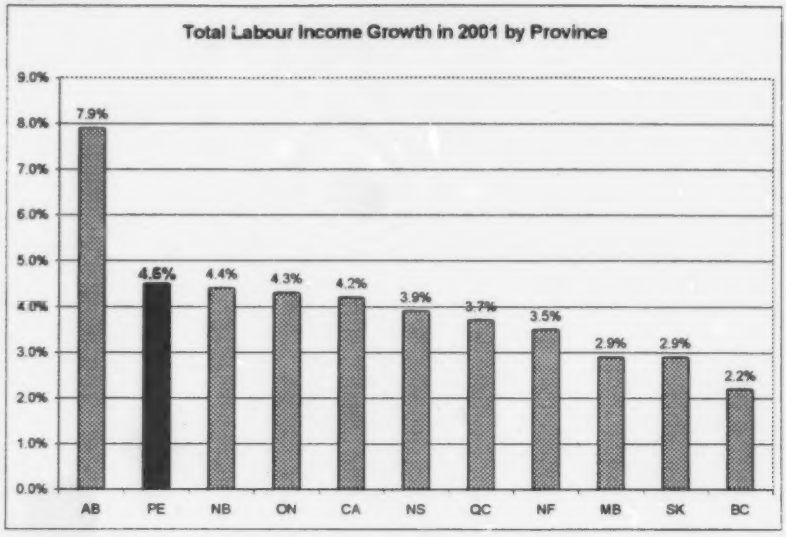
As Figure A.4 shows, the trend in the unemployment rate on PEI has been rising in the latter part of 2001.

The increased employment in 2001 was centred in the services sector, accounting for 79 per cent of the increase for an increase. The *professional, scientific, technical and education service* sectors registered the largest gains. Employment in the goods producing sector increased by 300, of which the highlight was an increase of 800 in *construction*. Employment in *agriculture* and *manufacturing* showed declines in 2001.

Personal Income

Increased employment on Prince Edward Island resulted in total labour income improving by 4.5 per cent to value $1,809 million in 2001. As can be seen in Figure A.5. Prince Edward Island was a national leader in total labour income growth in 2001. The total value of wages and salaries in the construction sector expanded by 16.4 per cent and the professional and personal service industry grew by 11.8 per cent. Large capital projects, including the construction of the hospital in Summerside and the Atlantic Technology Centre in Charlottetown, have bolstered employment and income in the construction sector.

Figure A.5



Source: Statistics Canada, Estimates of Labour Income.

In the fall of 2000 the Federal Government announced improvements to the Employment Insurance program, removing elements of the program that limited benefits to people working in seasonal industries and providing some expanded coverage for maternity leave from six months to one year. The value of Employment Insurance benefits on Prince Edward Island in 2001 totalled $188.8 million, an increase of 14.1 per cent over 2000. The increase in EI benefits is mainly attributed to a 36.1 per cent increase in the value of fishing benefits with smaller increases in sickness and maternity leave. The value of regular Employment Insurance benefits show a modest increase of 1.2 per cent.

Population

Statistics Canada estimates that the population on Prince Edward Island was 138,514 on July 1, 2001. This compares to 138,065 people in 2000, for growth of 0.3 per cent year over year.

The first release from the 2001 census was made on March 12, 2002 . Results from the Census population count are presented in Table A.1. The May 15, 2001 population count for Prince Edward Island indicates that 135,294 people resided on Prince Edward Island, an increase of 0.5 per cent since the 1996 census. This compares to national population growth of 4 per cent over the same period. The population increase on Prince Edward Island contrasts with the other three Atlantic provinces where population declines ranged from 0.1 per cent in Nova Scotia to 7.0 per cent in Newfoundland.

Table A. 1. Census Population Counts: 1996-2001.

	Census		%
Province / Territory	**1996**	**2001**	**growth**
Newfoundland	551,792	512,930	-7.0
Prince Edward Island	**134,557**	**135,294**	**0.5**
Nova Scotia	909,282	908,007	-0.1
New Brunswick	738,133	729,498	-1.2
Quebec	7,138,795	7,237,479	1.4
Ontario	10,753,573	11,410,046	6.1
Manitoba	1,113,898	1,119,583	0.5
Saskatchewan	990,237	978,933	-1.1
Alberta	2,696,826	2,974,807	10.3
British Columbia	3,724,500	3,907,738	4.9
Yukon	30,766	28,674	-6.8
Northwest Territories*	64,402	64,105	-0.5
Canada	28,846,761	30,007,094	4.0

** Northwest Territories including Nunavut*
Source Statistics Canada.

The official population, estimated by Statistics Canada, includes adjustments to the Census counts for net under-coverage errors. Revised annual population estimates for provinces and territories, incorporating the 2001 counts, will be available in the fall of 2003.

Consumer Prices.

Declining prices for gasoline and home heating oil during 2001 helped to dampen inflation on Prince Edward Island. Inflation on Prince Edward Island, as measured by the change in the Consumer Price Index for all items, was 2.6 per cent in 2001 compared with 4.1 per cent in 2000 when prices for home heating oil and gasoline were rapidly rising. The underlying rate of inflation, known as the core inflation rate, excludes the more volatile items including food and energy products was 2.1 per cent in 2001.

Detailed Industry Analysis

Agriculture

In the Spring of 2001, the outlook for the potato farming industry on Prince Edward Island was uncertain due to trade restrictions on potatoes destined to the United States and to other Canadian markets. The restrictions on potato exports were relaxed in April, prior to spring planting and were eliminated in August of 2001. Farmers planted 108,000 acres of potatoes on Prince Edward Island in 2001, an estimated 1,000 acres less than in 2000. The lack of precipitation during the latter months of the growing season contributed to a 39 per cent reduction in the volume of the potato harvest. Statistics Canada estimates that 17,820,000 cwt. of potatoes were harvested in 2001. A shortage of processing potatoes has reduced the production schedules at Island processing plants.

Potato prices improved in light of the reduced supply. According to the Provincial Department of Agriculture and Forestry's Farm Market Report, 10 lb bags of potatoes delivered to Toronto are now $1.80 compared to $0.68 one year ago.

Table A.2.
Annual Farm Cash Receipts, ($ Millions)

Year	Total Crop	Potato	Total Livestock	Cattle	Hog	Dairy	Direct Payments	Total Receipts
1997	**155.7**	128.8	**116.9**	29.8	29.2	47.1	8.0	**280.6**
1998	**201.7**	173.3	**109.5**	28.8	20.6	49.5	11.1	**322.3**
1999	**222.2**	192.2	**106.1**	24.8	21.9	49.0	18.7	**347.0**
2000	**186.3**	154.9	**118.6**	26.8	29.6	51.0	17.0	**321.9**
2001	**154.5**	126.0	**122.6**	25.0	33.5	52.5	58.5	**335.6**
Per Cent Change								
2001/2000	**-17.1%**	-18.7%	**3.3%**	-6.8%	13.2%	2.9%	245.3%	**4.3%**

Source: Statistics Canada, Farm Cash Receipts. Cat no. 21-603-XPB

Table A.2 shows the recent trends in farm cash receipts by major commodity from 1997 to 2001. Notwithstanding the difficulties in the farm sector in 2001, total farm cash receipts on Prince Edward Island rose by 4.3 per cent to value $335.6 million. The difficulties with marketing the potato crop caused by trade restrictions early in the year, and the reduced yields this past fall, reduced potato receipts by 18.7 per cent in 2001 compared to the previous year. Total livestock receipts improved by 3.3 per cent mainly on the strength of hog receipts. Compensation payments relating to the potato diversion program and increased crop insurance payouts due to the reduced yields in 2001 have resulted in direct payments totalling $58.5 million in 2001.

Fishing and Forestry

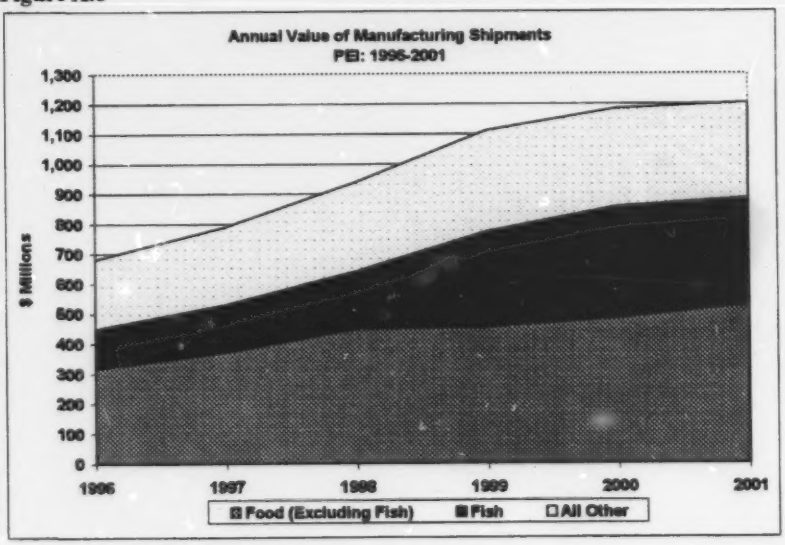
Preliminary estimates show that the total value of all fish landings on Prince Edward Island increased by 6 per cent to value $145 million in 2001. Buoyant lobster prices during the spring and fall seasons helped the value of lobster landings on Prince Edward Island to reach an all-time high of $100 million as estimated by the Provincial Department of Fisheries, Aquaculture and Environment. A decline of 40 per cent in the amount of herring quota allocated to Prince Edward Island and a trade dispute with the United States over cultured mussels dampened the overall increase in the fishing sector in 2001.

The ongoing dispute between Canada and the United States over softwood lumber has resulted in mill closures across Canada. Low lumber prices and uncertainty over the softwood lumber dispute caused Prince Edward Island's largest lumber mill to temporarily close in 2001. The total volume of wood harvested on Prince Edward Island was 703.6 cubic metres in 2001, down 11.5 per cent from 2000.

Manufacturing

The value of manufacturing shipments on Prince Edward Island posted growth of 1.6 per cent to value $1,202 million in 2001. Figure A.6. shows rapid growth in the value of manufacturing shipments in previous years with annual increases of 15 per cent since 1996. The value of food shipments, excluding fish products, rose by 9.3 per cent to value $526 million. Processed fish products, totalling $356 million, declined by 4.4 per cent in value. The value of all other manufacturing on Prince Edward Island declined by 2.8 per cent to value $320 million.

Figure A.6

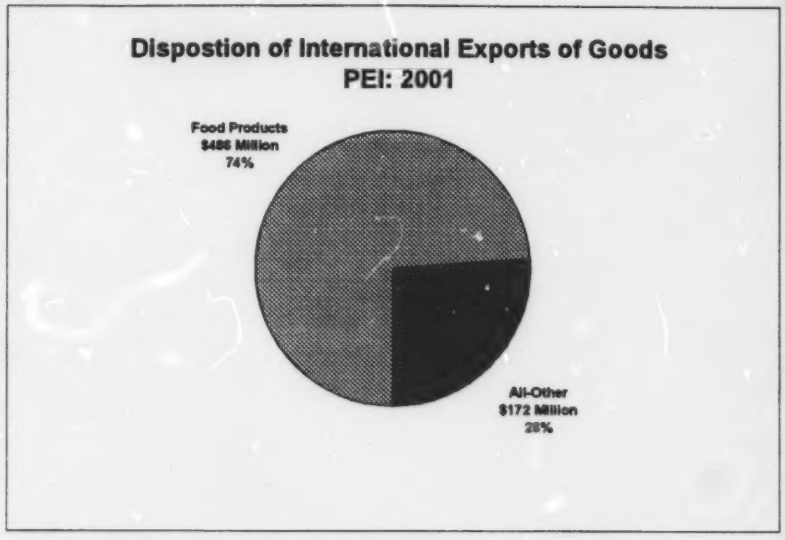


Source: Statistics Canada, Monthly Survey of Manufacturers.

International Export Performance

A slowing North American economy and trade restrictions had an impact on Prince Edward Island's export performance of goods in 2001, which declined by 3.7 per cent and valued $657.8 million. While the value of internationally exported frozen food products expanded by 15.2 per cent, this gain was more than offset by declines in the value of fish and raw potato exports. Fresh and processed food products represent approximately three quarters of Prince Edward Island's value of international exports in 2001, as illustrated in Figure A. 7.

Figure A.7



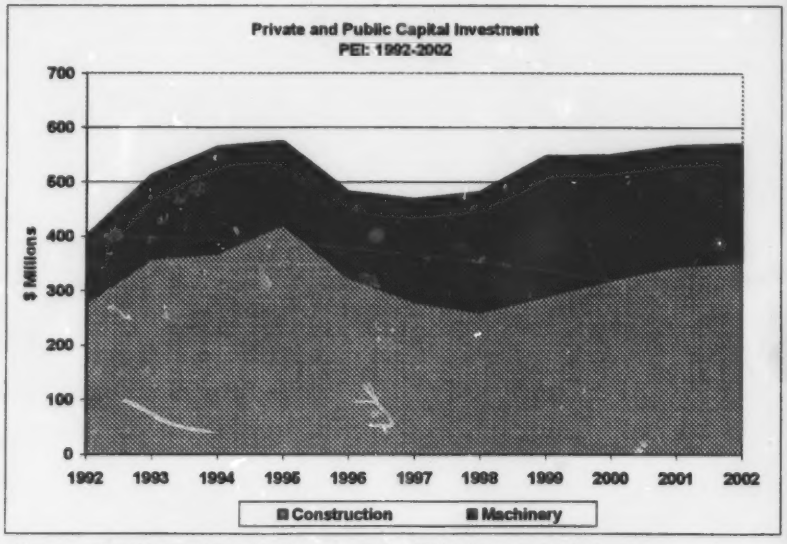
Source: Statistics Canada, International Exports.

The reduction in the total value of international exports was a limiting factor for growth in the manufacturing sector for Prince Edward Island in 2001.

Construction and Investment

The construction sector on Prince Edward Island grew vigorously in 2001. The total value of building permits, bolstered by a rapid increase in non-residential construction, saw an increase of increase of 112 per cent over the previous year totalling $209.2 million in 2001. While the value of residential construction permits rose by 9.9 per cent in 2001, the number of housing starts totalled 675 in 2001 compared to 710 in 2000.

Figure A.8



Source: Statistics Canada, Private and Public Investment Intentions.

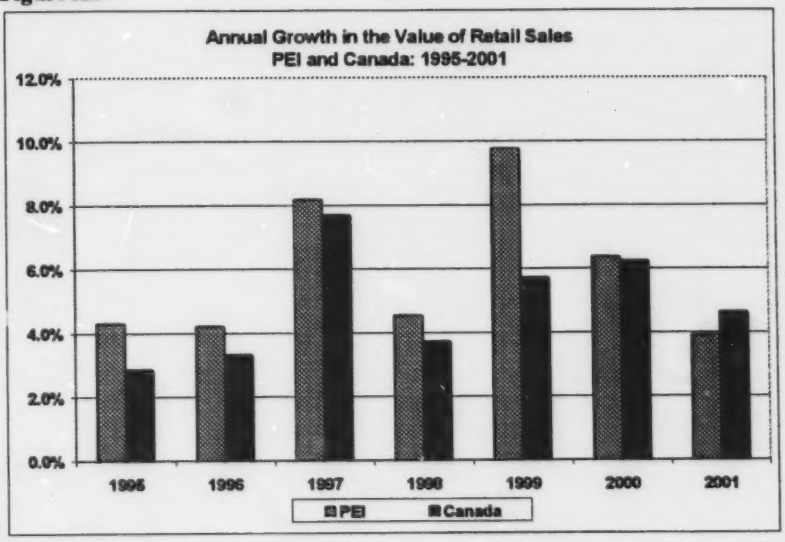
The construction sector is expected to remain buoyant in 2002. Figure A.8 shows the rising trend in construction since 1998. Statistics Canada's survey of the value of investment intentions for Prince Edward Island in 2002 is $571.1 million, an increase of 0.9 per cent compared to 2001.

The value of construction is expected to rise by 1.8 per cent, while the value of investment in machinery and equipment is expected to decline by 0.5 per cent.

Retail Trade

After surpassing the national growth rate for retail sales for the previous six years, the pace of retail expansion on Prince Edward Island slowed to 3.9 per cent in 2001, as shown in Figure A.9. This compares to the national growth rate for retail sales of 4.6 per cent in 2001. The total value of retail sales on Prince Edward Island in 2001 was valued at $1,278 million.

Figure A.9



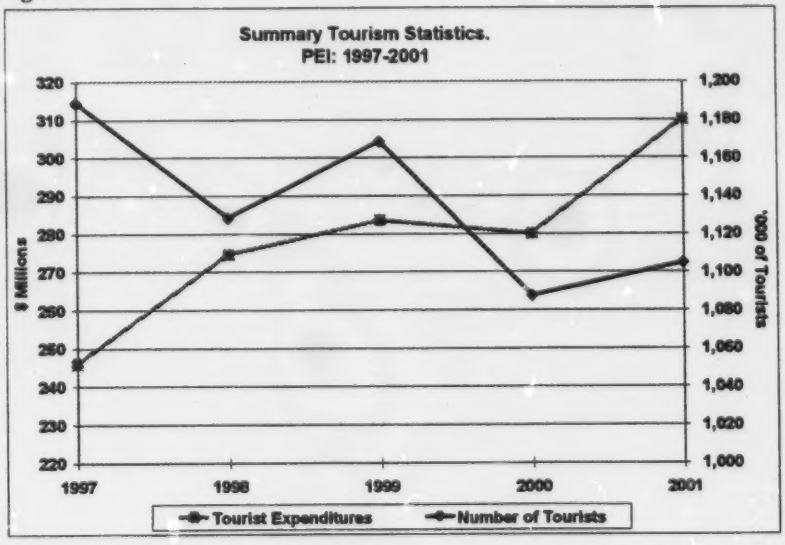
Source: Statistics Canada, Retail Sales.

The value of new motor vehicle sales on Prince Edward Island during 2001 totalled $120.6 million, a decline of 5.1 per cent compared to the figure for 2000. This contrasts with the record performance for car sales nationally.

Tourism Services

The extraordinary hot and dry summer along with several major events that were hosted on Prince Edward Island supported growth in the tourism sector in 2001. Figure A.10 shows the trend in the number of visitors and the amount of total spending by pleasure visitors. The Provincial Department of Tourism estimates that 1.104 million pleasure visitors came to Prince Edward Island in 2001. Tourism spending is estimated to have increased by 10.7 per cent in 2001 to value $310 million. Major events hosted on Prince Edward Island in 2001 included the East Coast Music Awards and the International Boy Scout Jamboree.

Figure A.10



Source: PEI Department of Tourism.

Government

In 2001-02 there were major wage settlements for provincial government workers. The largest unionized group, the Prince Edward Island Union of Public Service Employees, signed a three-year labour contract with a cumulative pay increase of 10.1 per cent over the three-year period. Doctors, teachers, and other groups, covered by collective agreements, signed contracts for varying amounts. The negotiated settlements in the 2001-02 fiscal year contributed to salary increases of $3.7 million in the general government sector, $1.8 million in the education sector and $8.6 million in the health sector compared to the 2000-01 fiscal year.

Summary and Outlook for 2002

The Department of Provincial Treasury estimates that the value of Gross Domestic Product on Prince Edward Island was $3,479 million in 2001. In constant dollars it is estimated to have increased by 1.3 per cent. The pace of economic expansion slowed in 2001 compared to average annual growth of 4.1 per cent since 1997. Economic growth in 2001 was led by rising employment, a buoyant construction sector and a rise in personal income.

Based on the current trends in the North American and local economy, the Provincial Treasury estimates that the Prince Edward Island economy will expand in the order of 1.2 per cent in 2002. This forecast is based on the expectation that the agricultural sector will improve due to more normal conditions for potato production. The goods producing sector is expected to expand by 3.2 per cent. The service producing sector is forecast to increase by a modest 0.7 per cent. Employment on Prince Edward Island is expected to grow by a more moderate pace of 0.7 per cent.

The Bank of Canada estimates that the Canadian economy will improve in 2002, that the worst of the economic downturn is behind us and that an economic recovery is currently underway. A moderate rate of growth is expected in the first half of the year then accelerating to something like 3 to 4 per cent during the last half of 2002. Provided that energy prices remain near their current levels, inflation in Canada is expected to be below 2 per cent for the next two years.

SUMMARY STATISTICS
PRINCE EDWARD ISLAND ECONOMY

	1995	1996	1997	1998	1999	2000	2001
Population on 1 July (in '000s) *	134.8	136.2	136.9	136.9	137.6	138.1	138.5
Personal Income per capita ($) *	18,822	18,926	19,197	19,861	20,688	21,746	22,388[1]
As % of Canadian Personal Income	*82.2*	*81.7*	*80.4*	*80.4*	*80.5*	*80.5*	*80.7*[1]
Employment (in '000s)	57.3	58.9	59.2	60.4	61.3	64.5	65.9
Unemployment Rate (%)	15.0	14.7	15.4	13.8	14.4	12.0	11.9
Unemployment Rate - Canada	*9.4*	*9.6*	*9.1*	*8.3*	*7.6*	*6.8*	*7.2*
CPI - Annual Change P.E.I. (%)	1.6	1.8	1.2	-0.5	1.2	4.1	2.6
CPI - annual change (%) Canada	*2.2*	*1.6*	*1.6*	*0.9*	*1.7*	*2.7*	*2.6*
Retail Trade ($ millions) *	894.0	931.7	1,007.9	1,053.7	1,156.6	1,230.1	1,278.1
New Motor Vehicle Sales (units) *	4,223	4,120	4,717	4,556	4,802	4,902	4,635
Farm Cash Receipts ($ millions) *	311.6	291.3	280.6	322.3	347.0	321.9	335.6
Potato Receipts ($millions) *	149.7	137.5	128.8	173.3	192.2	154.9	126.0
Lobster Landings ($ millions) *	79.2	61.7	73.4	82.6	88.9	85.8	100.0
Lobster Landings (lbs - millions)	*18.9*	*18.0*	*17.9**	*19.2*	*18.5*	*19.0*	*18.9*
Housing Starts (units)	422	554	470	524	616	710	675
Investment ($ millions) *	574.9	482.0	467.8	481.3	547.5	549.3	566.0
Manufact. Shipments ($ millions) *	686.9	678.8	788.8	937.6	1,109.0	1,183.1	1,202.1
Tourist Expenditures ($ millions) * [2]	146.6	160.1	245.9	274.4	283.4	280.0	310.0
International Exports ($ millions) *	340.0	353.7	435.2	466.0	566.5	682.9	657.8
GDP at Market Prices ($ millions) *	2,676	2,829	2,808	2,979	3,115	3,344	3,479[1]

* revised data

Note 1: Provincial Treasury estimate
Note 2: Expenditures do not include business travel

Sources: Statistics Canada; CMHC; Provincial Department of Fisheries, Aquaculture and Environment; Tourism P.E.I.

BUDGET PAPER B:

FEDERAL FISCAL ISSUES

BUDGET PAPER B:
FEDERAL FISCAL ISSUES

"Federal revenue performance is weak for a variety of reasons, and there is added uncertainty in the coming year over exactly what can be expected."

Hon. Patricia J. Mella - March 26, 2002

This paper summarizes outstanding issues and recent developments related to Prince Edward Island's fiscal relationship with the Federal Government. In particular, the Province's two largest transfer revenues, Equalization and the Canada Health and Social Transfer, are examined. Federal investments in regional economic development initiatives are also considered in turn.

During the past fiscal year, Prince Edward Island has pursued improvements to Canada's fiscal arrangements in consensus-based provincial-territorial discussions. Further, the Provincial Treasurer took the extraordinary step of appearing before the Parliamentary Standing Committee on Finance and the Senate Committee on National Finance to discuss her concerns regarding the Equalization program. While provinces and territories as a group have worked hard during the year to achieve unanimity in their ranking of national fiscal priorities, the Federal Government has resisted action on any of the provincial policy recommendations.

The Federal Government tabled its first full budget in two years in December of 2001. Its focus was to improve the nation's security and economy in the wake of the terrorist attacks of September 11. The budget ear-marked any surplus funds beyond these priorities to create a federal infrastructure program, expand international aid and pay down debt. It did not provide for any improvements to provincial financing for health care or Equalization, despite the unanimous appeal from Canada's Premiers.

For Prince Edward Island, federal revenues in the past fiscal year were somewhat higher than projected in last year's provincial budget, although until February 28, 2002, the federal Equalization payments were $28 million below the Province's budget estimate.

In the coming fiscal year, federal revenues to Prince Edward Island are expected to decline and will be subject to an exceptional degree of uncertainty.

Sharp absolute declines in Equalization during 2002-03 will outpace modest expansion in the cash transferred through the CHST and result in a level decrease in federal transfers. As well, the last of Prince Edward Island's Regional Economic Development Agreements (REDA's) with the Federal Government expired in 2001-02.

This fiscal instability stems largely from federal policy measures such as the current application of both the Equalization ceiling and floor for Prince Edward Island. Additionally, the Federal Government has yet to design its fiscal treatment to correct long-standing accounting errors made by the Canada Customs and Revenue Agency in assessing Provincial Personal Income Taxes, as described in Figure B.1. Although Prince Edward Island was not directly affected by the accounting errors, eventual corrections to provincial income tax revenues could lower provincial transfers substantially through both Equalization and the Canada Health and Social Transfer.

The results from the 2001 Census give rise to further concern as to revenue declines as population is a primary determinant of federal transfer financing. Subsequent adjustments to annual population figures will not be known until September 2003.

The Federal Budget in December 2001 announced a new federal infrastructure program to be cost-shared with provinces but without detail as to the type of projects to be undertaken or the basis of funding. This contributes to further budget uncertainties for provinces.

I. Provincial-Territorial Consensus

The 42nd Annual Premiers Conference was held in August 2001 in Victoria, British Columbia.

In the Premiers' joint statement following their meeting they made a very clear appeal to the Federal Government. In it, Premiers, *"invited the Prime Minister to join with them in following through on his commitment to achieve adequate and sustainable fiscal arrangements over the immediate to medium term, including:*

- *Immediate removal of the equalization ceiling;*
- *Immediate work on the development of a strengthened and fairer equalization program formula, including as one possible alternative, a ten-province standard that recognizes the volatility around resource revenues, and comprehensive revenue coverage;*
- *Restoration of federal health funding through the CHST to at least 18% and introduction of an appropriate escalator; and*
- *Work on other CHST measures, including tax-point transfers as one possible alternative to the current CHST cash transfer."*

Annual Premiers Conference Communiqué - August 2, 2001

The Premiers' consensus position underlines the serious harm that is done to fiscal equity in Canada by federal restrictions to its two largest and most important transfer programs.

Equalization, as enshrined in the Constitution, is mandated to "ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably

comparable levels of taxation." At the heart of this commitment is the guarantee that Canadians should expect their provincial government services and taxes to correspond to those enjoyed by Canadians living in other provinces. As provincial revenues and program responsibilities across the country increase, so too will the need for a well-functioning Equalization program. Arbitrary fiscal restrictions to the Equalization program widen existing gaps in Canadians' provincial public services and taxation rates across the country.

The Canada Health and Social Transfer is governed by federal legislation. Its mandate as stated in the *Federal Provincial Fiscal Arrangements Act* is to provide financing "for social programs in a manner that provides provincial flexibility", to ensure that the provisions of the *Canada Health Act* are maintained, to contribute "to providing the best possible health care system for Canadians".

Equalization addresses relative fiscal means across provinces, or *horizontal equity*. The CHST addresses the relative fiscal means of the Federal Government as compared to provinces as a group, or *vertical equity*.

In September 2000, the Federal Government established The Commission on the Future of Health Care in Canada, as chaired by former Saskatchewan Premier, Hon. Roy Romanow, to examine the sustainability of Canada's health care system. The final report of the commission is to be available in November 2002.

The Annual Premiers Conference also initiated a co-operative process to examine ways to improve service, manage costs and adequately fund Canada's health care system. Premiers, unwilling to wait two years to address health care challenges, convened the first of a series of meetings wholly dedicated to finding new approaches to improving health care for Canadians.

II. Federal Committees

Parliamentary Standing Committee on Finance

On April 26, 2001 Provincial Treasurer Patricia Mella addressed the Parliamentary Standing Committee on Finance in Ottawa to encourage them to honour Prime Minister Chrétien's pledge to raise the Equalization ceiling. She made a joint appearance before the committee together with the Finance Ministers from Newfoundland and Labrador, Nova Scotia and New Brunswick. Manitoba's Finance Minister addressed the committee as well.

The Standing Finance Committee was reviewing *Bill C-18, An Act to Amend the Federal Provincial Fiscal Arrangements Act* after its second reading, before it returned to Parliament for its third reading in the House of Commons. This act amended the existing Equalization legislation to lift the ceiling on Equalization payments temporarily for the 1999-2000 year only, to return it to its lower level thereafter.

Finance Ministers emphasized to the committee that this bill enacted only part of a commitment made to Premiers by Prime Minister Chrétien on September 11, 2000. At that meeting the Prime Minister issued a press release with the following commitment to provinces:

> *"The Minister of Finance will examine this issue further after consultation with provincial Ministers of Finance. ... the Prime Minister agreed that necessary steps would be taken to ensure that no ceiling will apply to the 1999-2000 fiscal year. Thereafter, the established Equalization formula will apply, which allows the program to grow up to the rate of growth in GDP."*
>
> *Rt. Hon. Jean Chrétien - September 11, 2000*

Premiers and their Finance Ministers viewed this as a very clear three-part commitment. The ceiling would be lifted for 1999-2000 and thereafter the ceiling would continue from this higher level and grow at the rate of growth in GDP. Premiers also understood that the federal Minister of Finance would hold meaningful discussions on this issue. Instead federal Finance Minister Martin held only cursory regional meetings with his provincial counterparts, providing no flexibility regarding any ceiling or other program changes.

Bill C-18 carries out only the first of these commitments. It was carried without amendment by the Parliamentary Finance Committee. The bill re-imposed a ceiling of $10.8 billion on national payments for the 2000-2001 Equalization year, following payments of $10.7 billion for the 1999-2000 Equalization year. Thus the program was constrained to growth of only 1.0 per cent, as compared to the 8.3 per cent increase in the Equalization ceiling that was consistent with the Prime Minister's commitment to Provincial Premiers. The ceiling currently reduces national Equalization payments by $142 million for 2000-2001.

The federal Senate later passed Bill C-18 without amendment.

Senate Committee on National Finance

> *"After five years as Provincial Treasurer, I find myself the longest serving Provincial Minister of Finance and during this period I have developed growing concerns over the inadequacies of this vital Program."*
>
> *Hon. Patricia J. Mella - October 24, 2001*

On October 24, 2001 Provincial Treasurer Mella made a second presentation to a federal Parliamentary committee, this time to the Senate Committee on National Finance Concerning the Equalization Program. This committee was given a mandate by the full Senate to review Canada's Equalization program more thoroughly, partly as a result of concerns raised during debate on Bill C-18.

In her presentation, Minister Mella emphasized the following points:

- The Equalization Program is an essential part of the Public Finances of Canada. It has a critical role in leveling the playing field across the country so that all persons and businesses can access reasonably comparable provincial services at reasonably comparable levels of taxation.

- The Equalization Program is a declining share of federal expenditures and its absolute amount will automatically rise and fall with general economic conditions. It has not been a burdensome program to the national finances.

- The Program has not been enhanced by the Federal Government over many years. Rather, the Federal Government has taken steps to reduce the standard by moving to five provinces and to gradually lower the ceiling. Recent federal claims that receiving provinces have been treated favorably are misleading. Relative to other provinces, the fiscal means of provinces that receive Equalization have clearly declined.

- The Representative Tax System is the basis of the present formula. It can be shown that this formulation provides the correct results in terms of estimating fiscal disparities between provinces and should be maintained for this reason.

- Concerns over the alleged disincentive effects of the RTS are misplaced and unproven.

- The ceiling is a direct attack on the very goals of the Program. The recent federal decision to further lower the ceiling by an unprecedented amount is very harmful to the Program. The Federal Government should respect the views of Premiers that the ceiling be abolished.

- The five-province standard presently in use results in rapidly increasing disparities between Alberta and other provinces. A ten province standard will allow the formula to more properly reduce fiscal disparities.

- The Program can only work adequately with comprehensive revenue coverage, which the Federal Government took active steps to restrict in 1999.

The Senate Finance Committee released its report on the Equalization program on March 21, 2002.

Both submissions by Minister Mella are available on the internet at:

www.gov.pe.ca/equalizationceiling

III. Prince Edward Island Federal Revenues

In 2001-2002, Prince Edward Island received $282.3 million in Equalization revenues and $86.6 million in CHST revenues. In 2002-03, Provincial Treasury estimates that the Province will record $255.0 million in Equalization revenues and $89.1 million in CHST revenues.

Federal Entitlements vs Federal Revenues

In recent years there has been some degree of confusion regarding the difference between the "provincial numbers" and the "federal numbers" in the statement of the Province's revenues, particularly Equalization. Provincial Equalization revenues at year-end equal the most current federal Equalization estimate for the year, plus or minus federal adjustments to past entitlements that have been made throughout that fiscal year. Historically-large prior year adjustments have increased the difference between year-end federal entitlement estimates and provincial revenue statements recently.

Provincial *revenue* figures differ from the current year *entitlement* figures for Equalization, and CHST, as normally reported by the Federal Department of Finance. The connection between the two fiscal concepts is explained below.

The Federal Government calculates the amount of transfers to Prince Edward Island for Equalization on the basis of a detailed formula that reflects population, fiscal and economic data. Entitlement estimates remain open for three and a half years and are revised every six months as more accurate data becomes available from Statistics Canada and Provincial Public Accounts. Just before a new fiscal year begins, the Federal Government produces an official estimate of the transfer Entitlements that it will provide to provinces for the following fiscal year.

The Entitlement revision process is similar for the CHST, although the formula is much simpler than the Equalization formula in that CHST reflects only population and income tax data in its re-calculations.

Table B.1 shows the evolution of Prince Edward Island's Equalization Entitlements for recent years. The first estimate for the 1997-98 Entitlement Year, made in February of 1997, determined that Prince Edward Island would receive $185,135,000 in Equalization so that it could provide public services to each of its residents to the standard in the five "representative" provinces. When the estimates for that year were finalized in October 2000, the Equalization formula determined that the actual amount of Equalization necessary to lift provincial finances to the five-province standard was $238,401,000. In other words, the initial estimate for the 1997-98 year was assessed to have been low by $53,266,000, or 22.3 per cent of the final figure.

Table B.1 - Prince Edward Island Equalization Entitlements: 1997-98 to 2002-03

Estimate Date	Equalization Entitlement Year					
	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03
	($000's)					
February 1997	185,135					
October 1997	193,767					
February 1998	198,882	198,584				
October 1998	211,710	201,255				
February 1999	233,100	221,546	222,000			
October 1999	236,243	227,793	231,564			
February 2000	238,491	231,602	240,567	236,094		
October 2000	238,401	233,339	247,903	257,017		
February 2001		236,888	249,587	256,112	254,302	
October 2001		237,504	245,456	256,367	250,844	
February 2002			254,703	272,821[1]	259,863[2]	247,239
Current Estimate	238,401	237,504	254,703	272,821	259,863	247,239
Difference in First to Current Estimate	53,266	38,920	32,703	36,727	5,561	-

Notes to Table:

1 The Fifth Estimate of Equalization Entitlements for 2000-01 includes a *ceiling* penalty of $1.6 million for Prince Edward Island. This amount is withheld from payments to the Province because national Entitlements under the program exceeded the legislated maximum of $10.8 billion, consistent with Bill C-18.

2 The Third Estimate of Equalization Entitlements for 2001-02 includes a *floor* payment of $5.9 million. This amount is paid to Prince Edward Island in response to a marked drop in Equalization payments after the 2000-01 year. Without the floor payment, Equalization Entitlements for 2001-02 are $254.0 million, which is effectively unchanged from the first estimate for 2001-02.

Table B.1 makes it clear that First Entitlements have significantly under-estimated subsequent estimates, which has resulted in the very large in-year revisions to provincial revenue seen in recent years.

Prince Edward Island's accounting rules treat any changes to transfers that occur within the fiscal year as revenue for that year. To use an example, Equalization revenues for 2001-2001 are based on the third federal estimate for 2001-02 Entitlement plus or minus any changes to other open years that have occurred since April 1, 2001. Table B.2 table displays the connection from Entitlements, as shown above, to annual provincial revenues.

Table B.2 - Prince Edward Island Equalization Revenues: 2001-02

	Estimate Year	Estimate Number		Estimate Adjustment ($)	In-Year Revenues ($)
Current Year Entitlements	2001-02		Third		259,863,000
Plus:	2000-01	*minus*	Fifth	272,821,000	
			Third	- 256,112,000	
				16,709,000	+ 16,709,000
Adjustments Made To Open Entitlements for Prior Years During 2001-02	1999-00	*minus*	Seventh	254,703,000	
			Fifth	- 249,587,000	
				5,116,000	+ 5,116,000
	1998-99	*minus*	Eighth	237,504,000	
			Seventh	- 236,888,000	
				616,000	+ 616,000
	1997-98	Closed Year: No adjustments			+ 0
Equals: **Total Revenues For 2001-02**					**282,304,000**

The Equalization revenues for the 2001-2002 fiscal year, which are $282,304,000, consist of the Equalization estimate for the 2001-2002 Entitlement year, at $259,683,000 plus the adjustments to earlier years of Equalization entitlements made between April 1, 2001 and March 31, 2002, which total $22,441,000.

Adjustments to prior years' Entitlements occur at regular intervals, as indicated in Table B.1.

At April 1, 2001, the Province had been paid $256,112,000 in respect of the Entitlement Year 2000-2001, which was calculated in the third federal estimate. By the fifth estimate, received on February 28, 2002, revised economic, fiscal and population data showed that Prince Edward Island was actually entitled to $272,821,000 for that year. The difference of $16,709,000 respecting 2000-2001 that was paid during 2001-2002 entered the revenues in the year in which it was received. Additional prior year adjustments of $5,116,000 and $616,000 were made for the 1999-2000 and 1998-1999 calculations respectively.

Revenues in 2001-02

In its 2001 Budget, the Province forecast Equalization revenues of $275 million for 2001-2002. In November, 2001, this forecast was revised down to $251 million, which matched the federal Entitlement estimate at the time, before prior year adjustments. The provincial revenue revision

reflected revisions by Statistics Canada's to provincial population estimates from 1998 to 2001, as well as potential economic consequences of the terrorist attacks in the United States, particularly as affecting national corporate income tax collections and natural resource prices.

In the federal estimates released on February 28, 2002, Prince Edward Island's entitlements were raised by $35 million as compared to the total federal estimates in October 2001. Of this amount, $26 million related to a change by Statistics Canada to its measurement of property values across Canada.

The Federal Department of Finance has announced that it will suspend recovery of the associated fiscal losses resulting from this change to property measurements until Statistics Canada can review its methodology in consultation with provincial statistical offices. This contributes to fiscal uncertainty in the coming fiscal year.

The February Equalization estimates also included a floor payment to Prince Edward Island of $5.9 million in respect of the fiscal year 2000-2001, which had not been anticipated at the time of the second quarter forecast.

Revenues in 2002-03

Just as the Equalization revenues for 2001-02 were based on that year's Entitlements plus adjustments for prior years, revenues for the coming year will be the sum of current year payments plus or minus any adjustments to prior years' Entitlements.

Prince Edward Island Treasury forecasts Equalization revenues of $255 million for 2002-03. This figure is based on an expectation that the Entitlement for 2002-03 will increase slightly from the first estimate value of $247.2 million. However, the Provincial Treasury forecast anticipates no appreciable prior year adjustments in the coming year. As such, Equalization Entitlements are expected to continue the pattern of decline in 2002-03, begun two years previous, when Entitlements peaked at $272.8 million.

The principal factor that will constrain Equalization Entitlements in 2002-03 is the slow growth in the national economy forecast during 2002, which reduces provincial revenue capacity across the nation, particularly through marked declines in natural resource royalties and corporate income tax collections. The de-indexation of most provincial personal income taxes, begun in 2001, will also serve to limit Equalization growth in 2002-03. A third factor, federal actions to correct historical administrative errors in its accounting of provincial personal income tax revenues is explained in more detail in Figure B.1. The magnitude of the impacts on Equalization cannot be quantified until the Federal Government makes its plans known to provinces.

Figure B.1 Federal Mis-allocation of Provincial Income Tax Revenues

The federal Canada Customs and Revenue Agency issued a press release on January 29, 2002 advising that it had discovered a very large error in the way that it records Provincial Personal Income Tax related to "T3 Mutual Fund Trusts". This error, dating back at least as far as 1972, led the Federal Government to make tax over-payments to some provinces of at least $3.3 billion.

Mutual Fund Trusts pay federal and provincial income tax on realized capital gains. Tax legislation sets out the circumstances under which Mutual Fund Trusts can receive refunds on some or all of this tax. However, no adjustment was made to deduct from provincial government revenues the provincial portion of capital gains refund. The federal share of the personal income tax on capital gains earned by Mutual Fund companies was remitted to those provinces as part of their personal income taxes instead of to the Federal Government. The largest over-payments were made to Ontario and Manitoba, where many Mutual Trust head offices are located, as shown below.

	Capital Gains Refunds By Province	
Province	**1993-1999**	**Annual Average**
Nova Scotia	$13,010	$1,859
New Brunswick	$20,739	$2,963
Ontario	$2,802,539,954	$400,362,851
Manitoba	$408,141,180	$58,305,883
Alberta	$4,412,858	$630,408
British Columbia	$120,623,276	$17,231,897
Total	$3,335,751,017	$476,535,860

Prince Edward Island received none of the misallocated money directly as the Province has no resident mutual fund companies.

The Federal Government has stated that they have corrected the problem for tax year 2000 and into the future. Questions remain over recovery of past overpayments.

In terms of Prince Edward Island, the direct overpayments did result in an indirect overpayment of Equalization of less than $1 million per year, according to the current formula, because total provincial revenues were incorrectly inflated by CCRA. It is not clear whether the Federal Government will alter the Equalization formula more substantially to reflect the change in relative fiscal capacities of affected provinces. This change to the Equalization "base" would result in further transfer declines for Prince Edward Island.

Finally, the Federal Government may act to recover amounts from past years from the provinces directly affected. Depending on how many past years they target and whether they make changes to transfer payments, the fiscal impact for Prince Edward Island of their decision could be substantial and negative.

Additional to the loss of economic momentum in 2001, prior year adjustments during 2002-03 will be constrained by two legislated features of the Equalization program, namely the ceiling and the floor.

As noted in Table B.1, the Equalization ceiling limits total payments for the 2000-01 Entitlement year. Although unlikely, positive adjustments are possible, if for example economic data were to show relative changes among provinces, or if the Federal Government were to lift the ceiling for that year.

One consequence of the Equalization floor is to limit possible improvements in payments to Prince Edward Island for the 2001-02 Entitlement Year during the coming fiscal year. If the Province's entitlements improve with new data, this increase in entitlements would trigger an off-setting decrease in floor coverage for the Province, restricting revenue gains in fiscal year 2002-2003.

The 2001 Census: A Serious Fiscal Concern

On March 12, 2002, Statistics Canada released its 2001 Census counts. Unlike all other Atlantic provinces, Prince Edward Island posted an increase in the Census count between 1996 and 2001, as shown in Table A.1. Statistics Canada will subsequently revise its official annual population figures to reflect the new Census results, as well as estimated under-enumeration in the Census. The revised annual population figures are scheduled for release in September 2003.

These Census-related population revisions will generate adjustments to revenue calculations in fiscal year 2003-04. Equalization and CHST calculations for all open years will be re-based to reflect the revised provincial population figures. In view of the Province's reduced share of national population, Provincial Treasury expects a negative impact on federal transfer payments when the official population estimates are revised by Statistics Canada in the fall of 2003.